

Department of Revenue
Colorado Lottery

Colorado Lottery

Performance Audit
November 2023
2259P



LEGISLATIVE AUDIT COMMITTEE

Senator Robert Rodriguez Chair	Representative Lisa Frizell Vice Chair
Representative Andrew Boesenecker	Representative <i>Vacant as of Report Publication Date</i>
Representative Gabe Evans	Senator Rod Pelton
Senator Rhonda Fields	Senator Kevin Van Winkle

OFFICE OF THE STATE AUDITOR

State Auditor	Kerri L. Hunter, CPA, CFE
Deputy State Auditor	Michelle Colin, JD
Audit Manager	Derek Johnson, MA
Audit Team	Adrien Kordas, MPA Guney Kuru, MA Hudson Marsh
Other Contributor	Monica Bowers



OFFICE OF THE STATE AUDITOR

C O L O R A D O

Working to improve government for the people of Colorado.



OFFICE OF THE STATE AUDITOR

KERRI L. HUNTER, CPA, CFE • STATE AUDITOR

November 20, 2023

Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the State Lottery Division. The audit was conducted pursuant to Section 44-40-120, C.R.S., which requires the State Auditor to conduct a performance audit of the Colorado Lottery at least once every 5 years, and Section 2-7-204(5), C.R.S., which requires the State Auditor to annually conduct performance audits of one or more specific programs or services in at least two departments for purposes of the SMART Government Act. The report presents our findings, conclusions, and recommendations, and the responses of the Colorado Lottery.

Kerri L. Hunter



Contents

Report Highlights	1
Chapter 1	
<i>Overview of the Colorado Lottery</i>	3
Lottery Games	3
Lottery Beneficiaries	5
Organization	6
Lottery Commission	7
Revenue and Expenses	8
Audit Purpose, Scope, and Methodology	9
Chapter 2	
<i>Lottery Operations</i>	11
Finding 1—Lottery Sales to Couriers	11
Recommendation 1	19
Finding 2—Lottery Commission Operations	20
Recommendation 2	26
Finding 3—Retailer Compliance Certifications	27
Recommendation 3	31
Finding 4—Restricted Player Database	32
Recommendation 4	35
Finding 5—Unusual Winning Patterns Analysis	36
Recommendation 5	41
Finding 6—Advertising Services Contracting Process	42
Recommendation 6	49
Appendix	
Statutory Considerations	A-1



Report Highlights



Colorado Lottery

Department of Revenue, Colorado Lottery

Performance Audit • November 2023 • 2259P

OFFICE OF THE STATE AUDITOR

C O L O R A D O

Key Concern

The Colorado Lottery (Lottery), within the Department of Revenue, should ensure that its sales practices, Lottery Commission operations, and contract selection processes are consistent with regulatory and statutory intent. It should also ensure that it has effective processes to identify and investigate unusual winning patterns, place the appropriate people on the restricted player database, and enforce licensing requirements.

Key Findings

- The courier sales model may not be consistent with the framework set up in statute for selling lottery tickets. Specifically, statute requires that lottery tickets only be sold by licensed retailers at their brick-and-mortar locations. Under the courier sales model, it may not be clear who is selling the tickets or where they are being sold—players place orders for lottery tickets and pay for them through a courier’s website or app and the courier then purchases the tickets from the licensed retailer. However, from the player’s perspective, they are purchasing the tickets online from the courier.
- Lottery Commissioners do not receive sufficient training or guidance in order to ensure that they fulfill the duties assigned to them in statute.
- 40 percent of licensed lottery retailers did not submit retailer compliance certificates for Calendar Years 2021 and 2022. Retailers attest in these certificates that they are in compliance with Lottery requirements.
- In February 2023, 23 of the Lottery’s 94 (25 percent) staff employed at the time were not included in the Lottery’s restricted player database, which is designed to prevent restricted players, such as Lottery employees, from winning higher-dollar prizes.
- The Lottery could not provide documentation to show that it had investigated individuals with multiple high-tier prize wins each quarter to determine if there was reasonable suspicion to investigate further. Our analysis of the Lottery’s multiple win reports for each quarter during Fiscal Years 2020 through 2022 identified:
 - One winner who claimed 44 prizes totaling \$38,500 in a single quarter in Fiscal Year 2022.
 - A retailer who made 10 claims totaling \$14,900 in a single quarter; this is the same retailer reported on in our 2018 audit report who, at that time, had 24 wins of \$600 or more over a 3-year period totaling \$39,750.According to Lottery policies, it should have conducted an in-depth review of these winners to determine if further investigation was needed, but there was no documentation that this review occurred.
- The Lottery’s selection process for its Fiscal Year 2023 advertising services contract and its procurement of a gambling prevalence study may not have complied with some state procurement requirements related to documenting the basis for its selection decision, appointing a person unaffiliated with the Lottery to serve on the evaluation committee, and subcontracting for additional services.

Background

- The Colorado Lottery was created in 1982 to allow for the establishment of state-supervised lottery games.
- The Lottery, which is a division within the Department of Revenue, is overseen by Lottery management and the Lottery Commission.
- The Lottery’s mission and goal is to maximize the revenue it generates from lottery game sales in order to support its beneficiary agencies.
- Currently, the Lottery offers 96 scratch ticket games that account for about 68 percent of the Lottery’s annual sales, and six jackpot games that account for about 32 percent of annual sales.
- In Fiscal Year 2023, the Lottery had ticket sales totaling about \$891 million, and it distributed \$195.3 million to its beneficiary agencies.

Recommendations Made

13

Responses

Agree: **13**

Partially Agree: **0**

Disagree: **0**



Chapter 1

Overview of the Colorado Lottery

The Colorado Lottery (Lottery) is a state agency that was created after voters passed a 1980 referendum to revise the Colorado Constitution and allow for the establishment of state-supervised lottery games. Senate Bill 82-119, enacted on April 30, 1982, created the Lottery as a division within the Department of Revenue (Department) and established the Lottery Commission (Commission). The Commission works with Lottery management to protect the public interest and trust in the Lottery and to maximize the sales revenue generated from lottery games. The Lottery is a cash-funded enterprise for budget and Taxpayer Bill of Rights (TABOR) purposes, meaning that it is self-sustaining and does not receive state general funds.

Lottery Games

The Lottery's revenue is generated primarily by selling tickets for a variety of lottery games of chance, each of which offers players the possibility of winning monetary prizes. Depending on the game, ticket prices range from \$1 to \$50 per play, and potential prizes range from \$1 to millions of dollars. The Lottery offers two categories of games:

- **Scratch Ticket Games.** Currently, the Lottery offers about 96 scratch ticket games for sale each year that account for about 68 percent of the Lottery's annual sales. Paper scratch tickets are sold at retailer store counters, Lottery offices, and in vending machines. Scratch games are introduced and retired continuously to ensure prize availability and maintain player interest. Scratch game sales increased 22 percent from Fiscal Year 2020 to Fiscal Year 2023, increasing from \$490.7 million to \$596.7 million, a new record high.
- **Jackpot Games.** Currently, the Lottery offers six jackpot games that account for about 32 percent of the Lottery's annual sales. Three of the jackpot games are multistate games administered by a national lottery association, the Multi-State Lottery Association (MUSL), of which Colorado is a member state. These multistate games include:
 - **Powerball**, which is offered in 45 states and the District of Columbia, U.S. Virgin Islands, and Puerto Rico. Powerball was introduced in Colorado in 2001, and offers a rolling jackpot with a minimum \$20 million prize that increases with each drawing until someone wins the jackpot. In August 2021, Double Play Powerball launched. Using the same numbers for the Powerball draw, players can spend an additional \$1 for the chance of winning \$10 million during a third weekly drawing.

- **Mega Millions**, which is offered in 45 states, the District of Columbia, and the U.S. Virgin Islands. Mega Millions was introduced in Colorado in 2010, and offers a rolling jackpot with a minimum \$20 million prize that increases with each drawing until someone wins the jackpot. In October 2017, the option for players to pay an additional \$1 to multiply the winning prize by a randomly selected number (excluding jackpot winnings) was added.
- **Lucky for Life**, which is offered in 25 states. Lucky for Life is a daily jackpot game introduced in July 2016, and offers a top prize of \$1,000 a day for life.

In addition to the three multistate jackpot games administered by MUSL, the Lottery administers three of its own jackpot games:

- **Colorado Lotto+**, formerly known as **Lotto**, is Colorado’s oldest jackpot game. The game was updated in 2019 to include bigger jackpots, better odds, a built-in multiplier, and a “plus” option. The game has a rolling jackpot with a minimum \$1 million prize.
- **Cash 5** is a fixed-jackpot game that offers a \$20,000 jackpot prize for each drawing. In 2017, a new add-on game, known as Cash 5 EZ Match, was introduced giving players the opportunity to pay an extra \$1 per Cash 5 ticket for a chance to win a randomly assigned instant prize.
- **Pick 3** is a matrix game in which players select three numbers between zero and nine. Pick 3 offers a top prize of \$2,500.

Exhibit 1.1 provides a breakout of sales by game for Fiscal Years 2019 through 2023.

Exhibit 1.1
Lottery Sales Breakdown (in Millions)
Fiscal Years 2019-2023

	2019	2020	2021	2022	2023	% Change
Scratch	\$443	\$491	\$573	\$590	\$597	35%
Powerball	\$86	\$51	\$67	\$83	\$110	28%
MegaMillions	\$73	\$38	\$57	\$35	\$85	16%
Colorado Lotto+	\$28	\$33	\$48	\$66	\$44	57%
Cash 5	\$17	\$16	\$16	\$14	\$14	(18%)
Cash 5 EZ Match	\$3	\$3	\$3	\$2	\$2	(33%)
Pick 3	\$13	\$13	\$16	\$15	\$16	23%
Lucky for Life	\$17	\$15	\$16	\$20	\$23	35%
Total (in millions)	\$680	\$660	\$796	\$825	\$891	31%

Source: Colorado Lottery Financial and Compliance Audit reports for Fiscal Years 2019 through 2023.

Lottery Beneficiaries

The Lottery's mission and goal is to maximize the revenue it generates from lottery game sales in order to support its beneficiary agencies. The majority of the Lottery's net proceeds (i.e., total revenue minus operating expenses and prize payouts) are distributed to the Great Outdoors Colorado (GOCO) program and the Great Outdoors Colorado Conservation Trust Fund (CTF) under a distribution formula established in the Colorado Constitution (Article XXVII). The amount distributed to GOCO is capped at a base amount plus inflation, which in Fiscal Year 2023 equated to a cap of \$75.7 million. Any proceeds exceeding the cap are distributed to other beneficiaries, as follows:

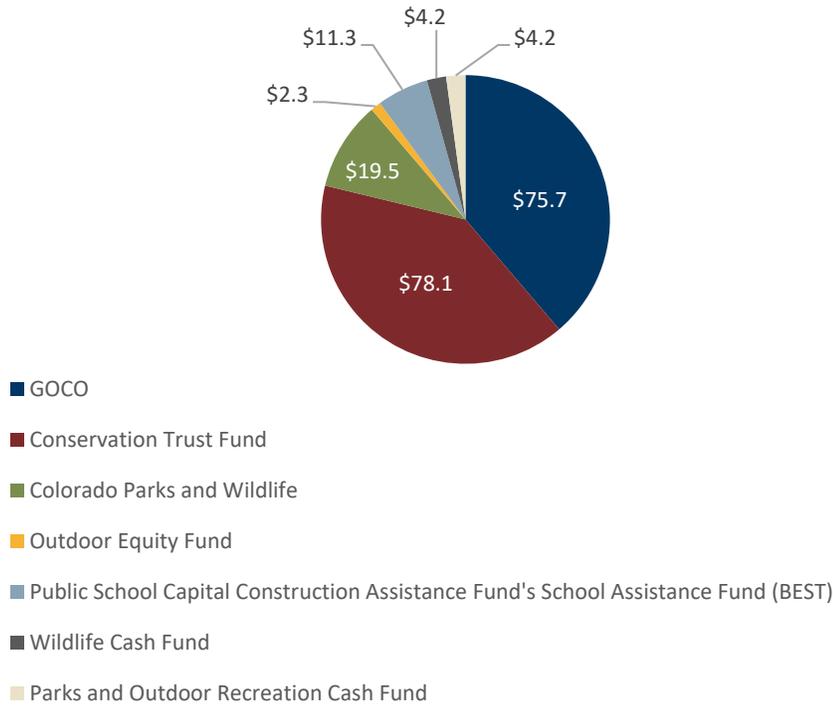
- 40 percent to CTF,
- 10 percent to Colorado Parks and Wildlife, and
- All remaining net proceeds in trust to the CTF Board, unless these extra funds exceed \$35 million (adjusted each year for changes from the 1992 Consumer Price Index-Denver), in which case the extra amount is allocated to the General Fund. From Fiscal Years 2009 through 2020, these funds have been transferred to the State Public School Capital Construction Assistance Fund.

The distribution to beneficiaries changed in Fiscal Year 2021 with the passage of House Bill 21-1318. This Bill created the Outdoor Equity Grant Program and established distribution formulas that change the amount that would otherwise be transferred to the General Fund resulting from any amounts exceeding the GOCO cap for Fiscal Year 2021 and onwards. According to Section 44-40-111(12) (b)(IV), C.R.S., for Fiscal Year 2024 the amount that would be allocated otherwise to the General Fund (after exceeding \$75.7 million, as adjusted by the Consumer Price Index) is to be distributed as follows:

- The first \$3 million to the Outdoor Equity Fund,
- The next \$3 million to the Public School Capital Construction Fund, and
- The remaining amount as follows:
 - 25 percent to the Wildlife Cash Fund
 - 25 percent to the Parks and Outdoor Recreation Cash Fund
 - 50 percent to the Public School Capital Construction Assistance Fund

Funds distributed or available for distribution from Fiscal Year 2023 sales totaled nearly \$195.3 million—an 8.3 percent increase in distributions from Fiscal Year 2022, a record-breaking mark in the Lottery’s history. See Exhibit 1.2 for Fiscal Year 2023 beneficiary distributions.

Exhibit 1.2
Distribution of Lottery Proceeds to Beneficiaries (in Millions)
Fiscal Year 2023



Source: Office of the State Auditor analysis of the Fiscal Year 2023 Colorado Lottery Financial and Compliance Audit.

Organization

According to statute [Section 44-40-104(4)(a), C.R.S.], the Lottery Director’s responsibilities include administering and supervising the Lottery in accordance with statute, Lottery Rules, State Fiscal Rules, State Personnel Rules, and State Procurement Rules, and administering any multistate agreements. In addition, the Director is responsible for entering into contracts and annually preparing and submitting to the Commission a proposed budget for the Division for the ensuing fiscal year [Section 44-40-105(1)(a) & 44-40-105(1)(b), C.R.S.]. The Lottery is headquartered in Pueblo, as required by statute [Section 44-40-102(1)(a), C.R.S.], and has satellite offices in Denver, Fort Collins, and Grand Junction. As of October 2022, the Lottery employed 100.5 full-time equivalent (FTE) staff, organized into the following units:

- **Executive and Lottery Administration**, including the Lottery Director, Deputy Director, and other management. (8 FTE)
- **Marketing and Communications**, including staff who coordinate advertising efforts, and collect data and conduct research to inform Lottery decision-making and marketing. (8 FTE)
- **Sales**, including sales representatives who recruit new retailers to sell Lottery products and ensure Lottery products are stocked for sale to the public. (36 FTE)
- **Security and Investigations, Licensing, Compliance, and Warehouse**, including investigators who conduct background checks on Lottery employees and vendors, investigate complaints if needed, and assist with criminal investigations. (18.5 FTE)
- **Accounting and Financial**, including the Lottery controller and accounting staff. (11 FTE)
- **Operations and Development**, including staff who conduct drawings and process claims. (19 FTE)

Lottery Commission

The Lottery is overseen by the Commission, composed of five members appointed by the Governor, with the consent and approval of the Senate. All members must be Colorado residents without any felony convictions for a gambling-related offense, and no more than three members can be of the same political party. Additionally, at least one Commission member must have been a law enforcement officer for at least 5 years; one member must have been a Colorado practicing attorney for at least 5 years; and at least one member must be a certified public accountant who practiced accountancy in Colorado for at least 5 years.

The Commission is a Type-2 entity, which means that most of the authority over the Lottery remains with the Department. However, the Commission retains rule-making authority, which generally is reserved for Type-1 entities. Statute [Section 44-40-109, C.R.S.] authorizes the Commission to provide oversight and governance of the Lottery through the following:

- Promulgating rules regarding the operation of the Lottery.
- Conducting hearings on complaints received regarding violations of Lottery rules.
- Carrying on a continuous study and investigation of the lottery throughout the state.
- Reporting the need for statutory changes in order to prevent abuses with the administration or operation of the Lottery.

- Requiring special reports from the Director as needed.
- Authorizing and issuing revenue bonds and setting the amount of the performance bond for contractors.
- Investigating and participating in multistate Lottery games.

Revenue and Expenses

In Fiscal Year 2023, the Lottery generated its highest revenue to date with \$889.8 million in ticket sales—a 34 percent increase from Fiscal Year 2020. Expenses in Fiscal Year 2023 totaled \$694.8 million, which included \$666.5 million in game expenses, such as prize payouts, retailer compensation, and game system maintenance. The Lottery also had \$28.3 million in non-game expenses, which consisted of office expenses, wages and benefits, and marketing and communications. Exhibit 1.3 provides the Lottery’s revenue, expenses, and FTE employees from Fiscal Years 2019 through 2023.

Exhibit 1.3

Colorado Lottery Revenue, Expenses (in Millions), and Full-Time Equivalent Employees Fiscal Years 2019 Through 2023

	2019	2020	2021	2022	2023	% Change
Gross Ticket Sales	\$679.8	\$658.8	\$794.9	\$826.9	\$889.8	
Other Revenues	\$0.2	\$0.2	\$0.2	\$0.2	\$0.5	
Total Revenue	\$680.0	\$659.0	\$795.1	\$827.1	\$890.3	30.9%
Game Expenses	\$483.4	\$489.1	\$596.2	\$618.8	\$666.5	
Non-Game Expenses	\$25.6	\$20.0	\$23.8	\$29.0	\$28.3	
Total Expenses	\$509	\$509.1	\$620.0	\$647.8	\$694.8	36.5%
Net Income Before Distributions	\$171.0	\$149.9	\$175.1	\$179.3	\$195.5	14.4%
Adjustments Before Distributions ¹	(\$4.5)	\$(7.4)	(\$5.8)	\$1.0	(\$0.2)	
Distributions to Beneficiaries	\$166.5	\$142.5	\$169.3	\$180.3	\$195.3	17.3%
FTE (actual)	113.4	100.5	94.5	98.5	100.5	

Source: Colorado Lottery Financial and Compliance Audit reports for Fiscal Years 2019 through 2023.

¹ Adjustments before distributions include, among other things, changes in value of investments, capital assets, and operating reserves.

Audit Purpose, Scope, and Methodology

We conducted this performance audit pursuant to Section 44-40-120, C.R.S., which requires that the State Auditor conduct a performance audit of the Lottery at least once every 5 years. Audit work was performed from October 2022 through October 2023.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

The objectives of the audit were to evaluate the Lottery's effectiveness in ensuring the integrity of its games and operations by evaluating the (1) controls over winning claims and payouts made to individuals claiming prizes, (2) contract management practices, (3) controls in place to ensure licensed sales agents operate within Lottery rules, (4) effectiveness of its security and investigations operations, and the (5) practices and duties of the Commission.

In developing these objectives, the audit considered each of the factors specifically outlined in Section 44-40-120, C.R.S. For a complete list of the factors see this report's appendix.

To accomplish our audit objectives, we performed the following audit work:

- Reviewed relevant state and federal laws and rules, Department policies and procedures, and Commission policies and procedures.
- Researched the legislative history of lottery statutes, including performing a review of House and Senate journals and listening to relevant committee audio.
- Reviewed the extension of two contracts established between the Lottery and its gaming service vendors, one that began in 2014 and was extended through 2025, and one that began in 2017 and was extended through 2027.
- Reviewed the 2022 award of a marketing services contract and associated documentation, including the request for proposal documents, offerer proposal materials, selection committee evaluation documentation, and protest documents.
- Reviewed the 2020 process for procuring a gambling prevalence study through an existing vendor.

- Interviewed Lottery staff and management as well as Commissioners, and conducted site visits to the Lottery Headquarters to conduct walkthroughs on the claims process and to two retailers to interview their staff and observe their processes for receiving orders from couriers through the internet.
- Analyzed Lottery security data including compliance records, complaints, and criminal investigations for Calendar Years 2021 and 2022, and the reports used to identify any unusual winning patterns among players for Fiscal Years 2020 through 2022.
- Reviewed the minutes for the Commission’s monthly meetings in Fiscal Years 2020 through 2022, the information packets provided by Lottery staff to the commissioners for a targeted selection of 10 meetings held during this period, and training materials that Lottery staff provided to Commissioners instructing them on their responsibilities. We also listened to recordings of a targeted sample of past Commission meetings in Fiscal Years 2019 and 2020, and attended six meetings in Fiscal Year 2023.
- Reviewed the Lottery’s website to view Commission meeting announcements for public notices of the six meetings the team attended in Fiscal Year 2023, and reviewed the Lottery’s social media accounts for Fiscal Years 2020 through 2022.

As required by auditing standards, we planned our audit work to assess the effectiveness of those internal controls that were significant to our audit objectives. Details about the audit work supporting our findings and conclusions, including any deficiencies in internal control that were significant to our audit objectives, are described in the remainder of the report.

A draft of this report was reviewed by the Lottery and the Commission. We have incorporated the Lottery’s comments into the report where relevant. The written responses to the recommendations and the related implementation dates are the sole responsibility of Lottery and the Commission.

Chapter 2

Lottery Operations

The Colorado Lottery’s (Lottery) performance is guided by three principal areas of focus: revenue, responsibility, and conservation. The Lottery’s core purpose is to create entertaining games for adults in order to grow revenue for the organization’s proceeds partners that support a variety of outdoor, conservation, and recreation projects and schools. As part of the Lottery’s goal of responsibility, its mission is to “maximize revenues for its proceeds recipients while demonstrating the highest level of integrity expected of a state agency” because “increased revenue goals cannot be achieved without responsibility, integrity, and security.”

Since the Lottery first began operating in Colorado in 1982, there have been many changes in how it operates, as well as changes to commerce, in general. In the Lottery’s first years of operation, it offered only a limited number of games. Over the years, the Lottery has expanded and now offers a larger array of lottery games, including several multistate and in-state jackpot games, all of which have multiple drawings throughout the week, numerous scratch ticket games with varying price points and prize amounts, and second chance drawings for non-winning scratch tickets. During this time, the world has also seen the introduction and proliferation of the Internet, with consumers buying more and more goods via e-commerce, especially in more recent years as a result of the COVID-19 Pandemic (Pandemic). Since the last performance audit in 2018, the Lottery has implemented several new options for players that make use of technology and the Internet, including allowing customers to purchase lottery tickets online through a courier’s website and allowing prize winners to claim their winnings electronically.

This chapter contains the results of our audit work from (1) examining lottery sales to couriers, (2) reviewing the Lottery Commission’s role in overseeing lottery operations, (3) reviewing licensed Retailer Compliance Certifications, (4) evaluating the Lottery’s controls over its Restricted Player Database, (5) reviewing the Lottery’s implementation of prior audit recommendations related to players with unusual winning patterns, and (6) examining the Lottery’s procurement of its advertising services contract. We focused our audit work on Lottery activities that occurred from July 2019 through June 2023.

Finding 1—Lottery Sales to Couriers

Since 1983, when the Colorado Lottery began selling its first games, lottery tickets have only been available for purchase in-person at brick-and-mortar licensed lottery retailers, such as grocery stores, convenience stores, and gas stations, as well as at Lottery offices and lottery-owned kiosks.

However, in 2019, a new type of business began operating in Colorado that allows customers to order lottery tickets from a business known as a “courier” through the courier’s website or app. The courier then purchases the tickets from their licensed lottery retailer’s brick-and-mortar store and delivers the tickets to the customer either electronically through the courier’s website, electronically through the courier’s app, or in hard copy through the mail.

According to Lottery documentation, the first company that intended to operate under this courier sales model in Colorado approached the Lottery in 2018, made a presentation to the Lottery Commission in June 2019, and began operating in November 2019. As of January 2023, there were two companies known to be operating as lottery couriers in Colorado. The second did not present to the Commission, but did inform the Lottery of its operation during the licensing process. Each of the couriers has a single associated licensed lottery retailer located in the state, as follows:

- Lottery courier Jackpocket has Winners Corner, a licensed retailer located in Pueblo.
- Lottery courier Lotto.com has Players Café, a licensed retailer located in Denver.

Players order tickets through two different methods, depending on the company. For Jackpocket, a player opens an account through the app and adds funds to the account. When the player orders a ticket, the money is taken from their account. For Lotto.com, players are able to order a variety of games directly on the website without creating an account into which they deposit funds to make their purchases. Couriers accept various types of electronic payments including debit and credit cards, and Paypal. When a player orders a jackpot ticket on the courier’s app or website, the courier’s system prints a Scantron-type sheet with the player’s selected numbers. These sheets are then fed through a lottery terminal at the licensed retailer’s store, and the official jackpot ticket is printed. This process is typically automated. For example, Winners Corner has more than 20 lottery terminals behind their storefront that, according to the store’s management, can print up to 15,000 jackpot tickets per hour. The courier purchases these jackpot tickets from their associated licensed retailer and securely stores the tickets until after the drawing. After purchasing the ticket from the retailer, Jackpocket shares an electronic scanned image of the jackpot ticket with the player who ordered it through the app. The other courier, Lotto.com, sends the player their numbers in the app without a scan.

When a player orders a scratch ticket from one of the couriers, Jackpocket purchases the tickets from their associated licensed retailer, and ships the purchased tickets to the customer; Lotto.com purchases the scratch ticket from their associated licensed retailer and then allows the player to scratch the ticket virtually online or by using a “quick scratch” feature that reveals their scratch card results.

Players pay convenience fees for purchasing lottery tickets through a courier. For Jackpocket, the player is charged 9 percent of the amount they add to their account plus an additional \$0.29 service fee each time money is added to the account. So, if a player wants to add \$50 to their account, the total amount they will be charged is \$54.79. For Lotto.com, the fees are based on which lottery

games the player purchases tickets for; these fees are charged for every ticket purchased. Exhibit 2.1 shows the additional fees charged by Lotto.com for the different types of lottery tickets.

**Exhibit 2.1
Lottery Game Prices and Fees Charged by Couriers**

Game	Ticket Price	Lotto.com Service Fee
Powerball	\$2.00	\$0.50
Mega Millions	\$2.00	\$0.50
Powerball with Power Play	\$3.00	\$0.70
Mega Millions with Megaplier	\$3.00	\$0.70
Colorado Lotto	\$2.00	\$0.40
Lucky for Life	\$2.00	\$0.40
Cash 5	\$1.00	\$0.20
Pick 3	\$0.50	N/A ¹

Source: Office of the State Auditor analysis of information on the web page for Lotto.com.

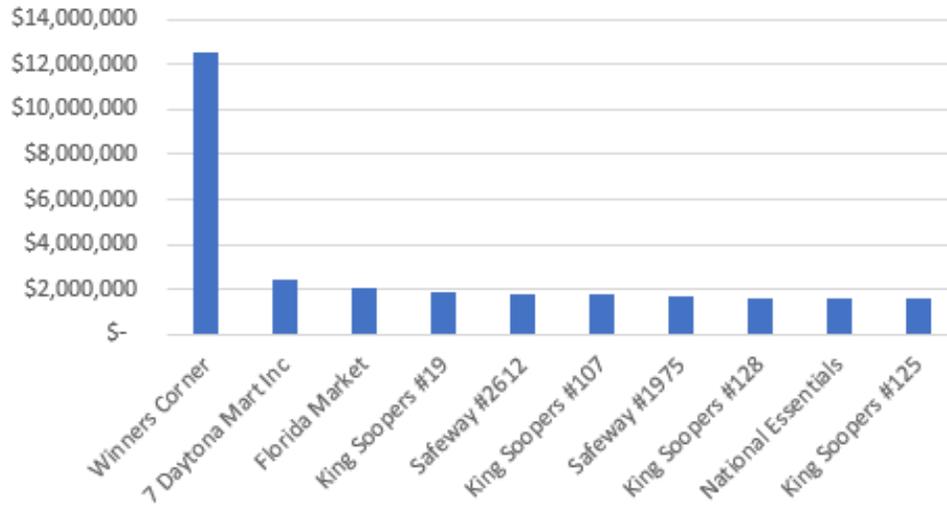
¹At the time of our audit, Lotto.com did not offer Pick 3 games for sale.

If a player wins \$599 or less, each courier, as applicable, cashes the ticket at their associated licensed retailer on the player’s behalf and then either credits the player’s account or pays the player the prize amount through their website or app; if a player wins more than \$599, the courier mails the winning ticket to the player or requires the player to pick it up at the courier’s brick-and-mortar store. The player can then claim their prize from the Lottery in-person at one of the Lottery’s four claims offices, via mail, or online.

Couriers in Colorado

Winners Corner, the lottery retailer associated with the courier Jackpocket, was operational for all of Fiscal Year 2022, and had the highest Lottery ticket sales of all licensed retailers in Colorado. Winners Corner had total lottery sales of \$12.6 million, which was five times higher than the next highest-selling retailer. Exhibit 2.2 shows the combined scratch and jackpot ticket sales for the top 10 highest-selling Colorado retailers for Fiscal Year 2022.

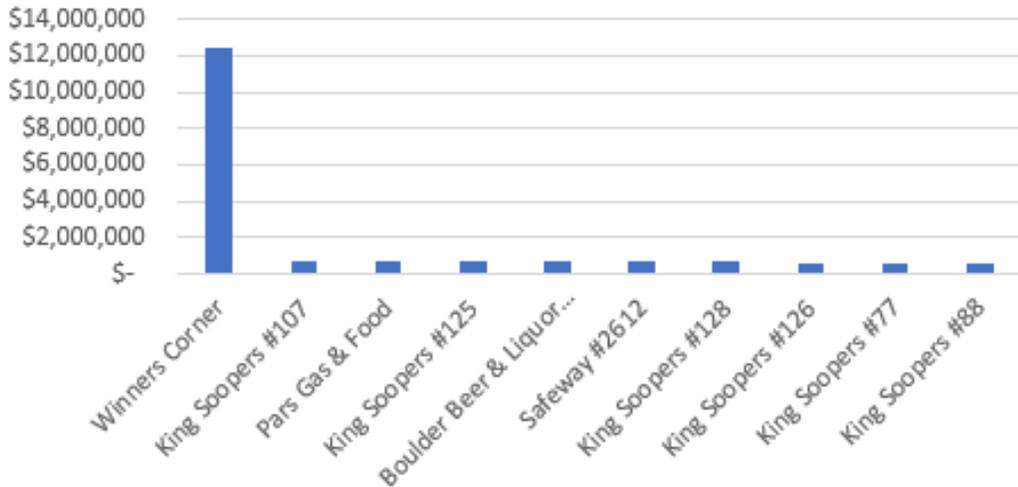
Exhibit 2.2
Top 10 Retailers in Sales for All Lottery Games
Fiscal Year 2022



Source: Office of the State Auditor analysis of Lottery sales data for Fiscal Year 2022.

The vast majority of sales by Winners Corner is for jackpot games, totaling \$12.4 million—more than 16 times the jackpot sales of any other retailer, as shown in Exhibit 2.3.

Exhibit 2.3
Top 10 Retailers in Sales for Jackpot Games
Fiscal Year 2022



Source: Office of the State Auditor analysis of Lottery sales data for Fiscal Year 2022.

The other active retailer associated with a courier, Players Cafe, began selling tickets to its courier in the last quarter of Fiscal Year 2022. Players Cafe had jackpot sales in Fiscal Year 2022 of about \$298,000, higher than the jackpot sales of 96 percent of all other retailers, including those in operation for the entire fiscal year. According to the Lottery, other couriers have tried to partner with established retailers but because couriers are not required to be licensed by the Lottery, they are not always immediately aware that a retailer has entered into such an agreement. As a result, the number of couriers that were active in our audit period is not entirely known.

What audit work was performed and what was the purpose?

We reviewed Lottery statutes and rules regarding the requirements for a retailer to be licensed to sell Lottery products. Additionally, we reviewed consumer complaints and license applications for Winners Corner and Players Cafe. We also visited both brick-and-mortar locations for these two retailers, where we spoke with the store managers, toured the facilities, and observed the courier operations to better understand their sales practices. We listened to audio and read associated minutes of Commission meetings at which couriers were discussed. We reviewed the websites for Winners Corner, Players Cafe, and Lotto.com, and the Jackpocket app. In addition, we reviewed documentation related to license enforcement actions to determine if the Lottery took any enforcement actions against the licensed retailers owned by a courier; this included one retailer that was no longer active as of the end of Calendar Year 2022.

The purpose of the audit work was to assess whether the operation of couriers and their associated licensed retailers is consistent with the intent of statute and Lottery rules.

What problems did the audit work identify and how were the results of the audit work measured?

Since the Lottery began, certain statutory and regulatory restrictions have been in place with respect to the sale of lottery tickets. These restrictions relate to who can sell lottery tickets and where tickets can be sold. Overall, we found that the sales model allowing couriers to play a significant role in the sale of lottery tickets in Colorado may not be consistent with the framework set up in statute for selling tickets. While we recognize that these statutes were enacted in the 1980s before the Internet and Internet commerce became such an integral part of the business world, this statutory framework is still in place and it is important that the Lottery's current practices are consistent with it. However, if the framework, or parts of the framework, are outdated, then it is important that the Lottery work with the General Assembly to propose changes to update statutes to more closely align with business practices today. We identified the following areas where it may not be clear that the courier sales model is consistent with the Lottery's statutory framework:

Who is selling lottery tickets? We found that it may not be as clear as statute seemed to have envisioned when the Lottery was established as to who is selling lottery tickets when a courier is

involved in the transaction. According to statute, it is unlawful for any person to sell a lottery ticket “unless authorized or licensed by the director to do so...” [Section 44-40-116(1)(b), C.R.S.]

According to the Lottery, couriers are not selling lottery tickets; rather, they are taking an order for a lottery ticket from a player and then purchasing the ticket from their associated licensed retailer on the player’s behalf. However, from the player’s perspective, they are ordering and paying for lottery tickets online through the courier’s website or app and players may assume that they are purchasing the tickets from the courier. Therefore, there may be some confusion for the public as to who is actually selling lottery tickets when they are ordered through a courier.

In addition, according to the Lottery, the couriers and their associated licensed retailers are separate legal entities and the Lottery only regulates the licensed retailers, since the Lottery does not consider the couriers to be selling the lottery tickets. However, information provided by one of the couriers to the Lottery Commission raises questions as to whether there is a clear distinction between the couriers and their associated licensed retailers. In a presentation made to the Lottery Commission in December 2019, Jackpocket representatives stated “We’ve become a licensed retailer in Colorado” and that Winners Corner CO LLC is a “wholly-owned subsidiary” of Jackpocket. In addition, each of these retailers share the same principal address as their associated courier—Winners Corner and Jackpocket in New York and Players Café and Lotto.com in New Jersey. Given the relationships between the couriers and their associated licensed retailers, the line between the two may not be clearly distinguished.

Where are lottery tickets being sold? We found that when couriers are involved in a lottery ticket transaction, there may be confusion to players as to where that sale is occurring. Statute states that it is unlawful for any person to sell a lottery ticket “at any place other than that place authorized and specified on the license” [Section 44-40-116(1)(d), C.R.S.]. This means that lottery tickets must be sold at the brick-and-mortar location of the licensed lottery retailer. According to the Lottery, “All of the transactions for the sale of Lottery products by Winners Corner occur on their licensed physical premise[s] in ...Colorado. When Winners Corner sells tickets to Jackpocket, Jackpocket purchases those tickets at Winners Corner on its licensed premise[s] in...Colorado.” The Lottery described the relationship between Players Café and Lotto.com in exactly the same way. Therefore, according to the Lottery, the courier’s purchase of the lottery ticket is occurring at the licensed retailer’s brick-and-mortar store, in accordance with statute. However, from the player’s viewpoint, the sale is occurring wherever the customer purchases the ticket. When the player orders a lottery ticket through a courier’s website or app, the player likely believes that the sale is occurring through the internet. Additionally, in its 2019 presentation to the Commission, Jackpocket stated that “One single retailer will allow us to scale statewide,” which implies that Jackpocket saw the courier business model as providing an opportunity to sell lottery tickets across the state, not just in one physical location. Although lottery ticket sales may be technically occurring at the licensed retailers, there is a question as to whether this approach is consistent with the typical sales model in place when statute was enacted.

Why did these problems occur?

The concerns identified occurred because the Lottery licensed retailers that were established to sell to their couriers without conducting a thorough assessment of whether the courier sales model is consistent with the Lottery's current statutory framework, and whether the Lottery would benefit from obtaining regulatory authority over couriers. According to Lottery management, before applying for licenses, both Winners Corner and Players Cafe approached the Lottery to explain their intent to open a licensed retailer location that would be associated with a courier operation that would also have a processing center on-site. The Lottery told us that it determined that licensing these retailers would be allowed because they met all of the requirements.

The Lottery also discussed the courier sales model with the Lottery Commission and Jackpocket made a presentation to the Commission in June 2019 about its plans to enter the market. At the meeting, there was some discussion about where the sale occurs under the courier sales model and some Commissioners voiced concerns about how this model would affect existing retailers. At its July 2019 meeting, the Commission held an executive session regarding Jackpocket, and at the August 2019 meeting, Jackpocket gave an additional presentation to the Commission on how it operates. At the Commission's December 2019 meeting, Jackpocket informed the Commission that it had begun operating and provided some information about its associated licensed retailer. Although the Commission did not vocally oppose this sales model, there were no discussions by the Commission in the public portions of the meetings on whether the model remains in line with the statutory requirement, or affirmation, perhaps by a recorded vote, that the Commission thought this model was something the Lottery should embrace.

Throughout this process, the Lottery did not recommend any changes to rules or statute to explicitly recognize the presence of couriers and how licensed retailers should interact with couriers, or to seek the authority to regulate couriers. Any of these actions would have been prudent, particularly in light of language added to statute in 2014. Specifically, House Bill 14-1142 prohibited the Commission from adopting any rule or policy before July 1, 2017, that would authorize "the purchase of tickets, including instant scratch tickets or shares by means of the internet, telephone, computer, or any other electronic device or equipment ...other than by doing so *personally* at a licensed lottery sales agent's physical place of business." [emphasis added] The bill sponsor suggested that establishing this prohibition for a specified time would lead to the General Assembly reconsidering electronic sales after July 2017. Although the prohibition has expired, and we found no indication that the General Assembly has since revisited this issue, House Bill 14-1142 clearly indicates that the General Assembly expected to have input, along with the Commission, on when and if Lottery sales would be permitted by a means other than the traditional approach of a player making the purchase, in-person, at the licensed retailer's place of business.

Why do these problems matter?

Lack of Courier Sales Model Oversight. Licensing retailers who sell to couriers may not be consistent with the framework set up in statute for selling lottery tickets and does not allow for the Lottery to have sufficient oversight of couriers. By not regulating couriers, the Lottery increases certain risks related to the integrity, honesty, and fairness of its business. The statutes and rules cited above, which have remained unchanged since the early 1980s, establish requirements that help ensure that Lottery operations are transparent, lawful, ethical, and protective of the public trust. While the letter of the law might be followed under this courier sales model, it may not be in the spirit under which the laws were created.

In addition, the investigation of license applicants is one of the primary means by which the Lottery ensures the integrity of Lottery operations. The application and investigation processes involve the Lottery collecting information about applicants' prior business histories; ownership and management structures, including any holding, intermediary, or subsidiary companies; the names of key directors, managers, and investors; and financial history. Examining an applicant's criminal history is key to the Lottery's appraisal of their suitability as licensees. Both statutes and rules generally prohibit the licensing of applicants that have been convicted of felonies or offenses involving gambling, fraud, or misrepresentation, or that have engaged in bookmaking or other forms of illegal gambling. Statutes require that a license be revoked if the holder is found to have been dishonest with the Lottery, endangered the security of the lottery, or have a character that is no longer consistent with protection of the public interest and trust. [Section 44-40-107(2)(a), C.R.S.] Because Jackpocket and Lotto.com are couriers, and separate legal entities from Winners Corner and Players Café, the Lottery has not investigated their backgrounds, in spite of their intrinsic role in lottery ticket sales.

Further, players pay more out-of-pocket to order lottery tickets through a courier than they pay for a ticket at a brick-and-mortar store, due to convenience fees charged by the couriers. Given that there is no current framework for the Lottery to regulate the couriers, the Lottery does not regulate the amount of fees that they charge. Statute provides that it is unlawful for any person to sell a lottery ticket "at a price greater than or less than that fixed by the commission" [Section 44-40-116(1)(a), C.R.S.]. According to the Lottery, the couriers are not charging players more for the lottery tickets than they would have to pay if they went to a store to purchase the tickets. Instead, the couriers are charging convenience fees, in addition to the ticket prices, to pay for the services provided by the courier such as purchasing the tickets from the associated licensed retailer, scanning the tickets, mailing or virtually scratching scratch tickets, and cashing in winning tickets on behalf of the player and paying out the winnings. We recognize that these are additional services that couriers provide to players and because of these services, players do not have to physically go to a store to buy a lottery ticket or cash in a winning ticket. However, there are some aspects of the convenience fees charged by the couriers that could raise questions as to whether these fees are actually service fees. For example:

- The convenience fees charged by Lotto.com are not charged on each purchase, but rather on each play. For example, if a player purchases one line on a Colorado Lotto+ game, the player plays a fee of \$0.40. However, if the player plays two lines on the same game—which would still only require one printout of the ticket, storage of one ticket, and possibly shipping of a single ticket—the fee is \$0.80.
- For Lotto.com, its fees are determined by an algorithm that assesses the demand elasticity of each game and the fees have no basis in Lotto.com’s costs.

The sale of tickets to couriers on behalf of players may impact small businesses. The sponsor of House Bill 14-1142, which prohibited any rule or policy allowing online ticket sales until at least July 1, 2017, noted that one reason for the restriction was the potential impact of such sales on small businesses. The bill sponsor indicated that when the Lottery was first created, there was an implicit promise to small businesses that they would be able to benefit from Lottery sales. Additionally, at the June 2019 Commission meeting where Jackpocket made its presentation, Commissioners expressed some concern on this matter as well. By allowing players to use a courier for ordering tickets that are processed at the brick-and-mortar locations that are wholly owned subsidiaries of the couriers, the sales at small independent businesses selling tickets in person, at their brick-and-mortar locations, might be negatively impacted.

Online commerce is now the norm and it has the potential to continue to increase Lottery sales and beneficiary proceeds. As such, it is reasonable for the Lottery to allow this courier sales model, or even a true online sales model, in the future. However, the Lottery should carry out planning and risk assessment as a precursor to these significant changes, make the process transparent to the public, and obtain the input and support of the General Assembly through statutory changes, if required.

Recommendation 1

The Colorado Lottery (Lottery) should work with the Lottery Commission (Commission) to identify any changes that may be needed with the Lottery’s current regulatory or statutory framework to ensure that the courier sales model is consistent with statute and the Lottery’s rules. The Lottery should then propose any necessary regulatory or statutory changes identified to the Commission and the General Assembly, as necessary.

Response

Colorado Lottery and Lottery Commission

Agree

Implementation Date: June 2024

The Colorado Lottery (“Lottery”) and the Lottery Commission (“Commission”) will work with legal counsel to review statute and rules to ensure that the courier sales model is consistent with both. If changes to statute or rule are necessary, the Lottery will propose those changes to the Commission and/or the General Assembly, as necessary.

Finding 2—Lottery Commission Operations

The Commission consists of five members appointed by the Governor with consent of the Senate. Statute contains experience requirements for three of the members: one must have served as a law enforcement officer for not less than 5 years, one must be a lawyer in practice for at least 5 years, and one must be a certified public accountant (CPA) who has practiced for at least 5 years [Sections 44-40-108(2) and 109, C.R.S.]. The other two members are only required to be citizens of Colorado who have not been convicted of a felony or gambling-related offense. The members serve 4-year terms and may be reappointed without limitation. At the time of our audit, the Commissioners had served terms ranging from about 1 to 7 years. The Commission is a rulemaking body that meets monthly, typically by video conference. The Commission has created rules related to a wide variety of Lottery functions, including rules related to licensing retailers; the types of games offered; ticket prices and prize amounts; where and how Lottery products may be purchased; and how winning tickets are determined.

What audit work was performed and what was the purpose?

We reviewed relevant statutes, regulations, and Lottery policies and procedures, and interviewed all five Lottery Commissioners to understand how the Commission functions. We also attended the six monthly Commission meetings that were held from February 2023 through July 2023 and listened to audio from Commission meetings held in June 2019 and December 2019.

In addition, we reviewed the minutes for each of the Commission’s monthly meetings in Fiscal Years 2020 through 2022 and reviewed the information packets provided by Lottery staff to the Commissioners for a targeted selection of 10 meetings held during this period to identify the topics covered at the meetings and the materials Commissioners received in advance of the meetings. We reviewed the Lottery’s website to view Commission meeting announcements for the six meetings we attended to determine whether the Commission provided sufficient public notice prior to each of the meetings. We also reviewed the Lottery’s Twitter feed and Facebook posts made during Fiscal Years 2020 through 2022 to determine if the Lottery actively promoted Commission meetings to the

public on their social media. Finally, we reviewed all training materials that Lottery staff provided to Commissioners instructing them on their responsibilities.

The purpose of our audit work was to determine if the Commission operates effectively in performing its duties set forth in statute.

How were the results of the audit work measured?

Rulemaking. According to statute, one of the Commission’s fundamental duties is to “promulgate rules governing the establishment and operation of the lottery.” [Section 44-40-109(1)(a), C.R.S.]. Statute specifies certain topics that must be covered by the Commission’s rules, including:

- Licensing of those who sell lottery products [Section 44-40-104(4)(d) and 44-40-107(1), C.R.S.]
- Where and how Lottery products may be purchased [Section 44-40-109(2)(f), C.R.S.]
- Certain financial matters, including the compensation for licensed sales agents [Section 44-40-109(2)(h), C.R.S.] and the collection of Lottery sales revenues [Section 44-40-109(2)(i), C.R.S.]

Public Communication and Engagement. The Commission must allow the public to participate in, and be informed about, its meetings and decisions. The General Assembly has had a declaration in place for decades that “public participation in government produces better government” and has established the following requirements for state boards and commissions in order to “promote as much public participation in government as possible” [Section 24-3.5-101, C.R.S.]:

- Meetings must be open to the public [Section 24-6-402(2)(a), C.R.S.]
- Provide full and timely notice, no less than 24 hours, and in a public place, before meetings can be held [Section 24-6-402(2)(c)(I), C.R.S.]

What problems did the audit work identify?

Overall, we found that the Commission may not be effectively fulfilling its duties, as outlined in statute. First, although the Commission has promulgated rules in the past to help establish the Lottery’s operations, we found that with the implementation of several recent Lottery initiatives, the Commission has not promulgated any rules nor taken any official action related to these initiatives. Specifically:

Lottery Ticket Sales to Couriers. As discussed in the first finding in our report, in December 2019, the Lottery began licensing retailers whose primary business model is to generate lottery ticket sales through a company known as a “courier.” Couriers are businesses that take lottery ticket orders

from players through their app or website; the courier then purchases the lottery tickets for the players from its associated licensed lottery retailer.

The Lottery discussed the courier sales model with the Commission at its June, July, and August 2019 meetings before the first courier began operating in Colorado. However, the Commission did not propose a rule change or affirm that it was in favor of this new lottery sales model at any of these meetings. According to minutes from the three meetings, meeting recordings, and interviews with the Commissioners and Lottery management, the Commission did not identify this as an initiative that required rulemaking or a public decision even though it was a departure from the way players had traditionally purchased lottery tickets in Colorado. The General Assembly had recognized previously, with the passage of House Bill 14-1142, that a change to allow players to purchase lottery tickets electronically, rather than in-person at a Lottery retailer, would be within the Commission's decision-making authority. Specifically, statute [Section 44-40-109(2)(f) and (g), C.R.S.] includes a provision stating that the Commission shall not pass any rule, issue any order, or adopt any policy or interpretation before July 2017, to authorize the purchase of tickets via the internet, telephone, computer, or other electronic device other than by personally doing so at a licensed lottery sales agent's physical place of business. Although this deadline has passed, the language in statute indicates that the Commission would typically have the authority to make this type of change. According to the Lottery, this provision would not have applied to the courier sales model because players are not technically purchasing tickets via the internet; rather they are placing orders for tickets and the couriers are purchasing the tickets at a brick-and-mortar store. However, the distinction between online sales and courier ticket orders is very nuanced and from the player's perspective, they are purchasing the tickets online because they place the order online and make the payment online. Nonetheless, the fact that this provision was in statute indicates that lawmakers considered this type of change in how players can purchase lottery tickets to be significant enough to require some action by the Commission prior to implementing it.

Electronic Claims. In October 2021, the Lottery began allowing players to claim prizes of \$600 or more electronically via email through a secure third-party software program. Prior to this, Commission rules required claims of \$600 or more to be made in-person at a Lottery claims center, or via mail by submitting the winning ticket directly to the Lottery [1 CCR 206-1-5.8(c)]. In order to allow for this change, the Commission revised the rules to remove this requirement, allowing for the possibility of claiming prizes in another manner. However, the Commission did not add language to the rule to explicitly allow players to claim prizes through an electronic means or to clarify if there are any requirements related to claiming prizes in this way, such as whether there are any restrictions on the prize amounts that can be claimed online in order to ensure the cost of processing claims this way is not prohibitive or to control for possible higher tier claims such as those larger than \$100,000.

Second, we identified one Commission meeting—May 10, 2023—for which the Commission did not post a meeting notice on the Lottery's website with the date and time or an agenda until after the meeting occurred. According to the Lottery it did post notice of this meeting in its claims offices, which was its practice prior to the Pandemic. At this meeting the Commissioners met in-person with

an option for attendance by video conference. However, as almost every meeting since 2020, when the Pandemic began, has been held via video conference, and the links to the meetings have been posted online, it would stand to reason that the general public would look to the Lottery’s website for that information. Statute requires boards and commissions to give “full and timely notice . . . no less than twenty-four hours, prior to the holding of the meeting.” [Section 24-6-402(2)(c)(I), C.R.S.]. The audit team had to reach out to the Commission secretary in order to obtain a link to attend the meeting virtually. At this meeting, the Commission heard a presentation about accepting cashless payments, which would be a major shift in the Lottery’s business model.

In addition, the Commission does not appear to be taking steps to “promote as much public participation in government as possible,” as directed by statute [Section 24-3.5-101, C.R.S.]. The statute concerning the requirement that we conduct a performance audit of the Lottery every 5 years includes specific language for the audit team to take into consideration, “[w]hether the commission encourages public participation in its decisions rather than participation only by the people whom it regulates” [Section 44-40-120 (1)(c)(VI), C.R.S.]. Our review of Commission meeting minutes for Fiscal Years 2020 through 2022, found that there was participation from the general public (i.e., players or retailers as opposed to individuals who are generally stakeholders in Lottery’s business) in only 2 of the 37 meetings (5 percent) held during these 3 years. The meeting minutes for these two meetings showed that, at one meeting, there was a member of the public who had concerns about the second chance drawings conducted by the Lottery and another meeting where a player expressed concerns over a scratch ticket they were told was irredeemable. For the other 35 meetings, two had members of the general public (i.e., not representatives of Lottery vendors or state agencies affiliated with the Lottery) present during the meetings, but they did not offer any comments during the meeting. Thirty-three meetings had no record that members of the general public were present, although there were representatives from vendors, beneficiaries, and other stakeholders who were present.

Why did these problems occur?

The Lottery could improve on the guidance that it provides to Commissioners on their duties. In 2018, the General Assembly passed legislation that provided best practices for boards and commissions across state agencies. All state boards and commissions, including the Commission, are required to have written policies and annual training on specific topics [Section 24-3.7-102(1), C.R.S.], including:

- Understanding and operating within the limits of their statutory directives and legislative intent [Section 24-3.7-102(1)(a), C.R.S.];
- Defining their role in the oversight of projects or entities [Section 24-3.7-102(1)(b), C.R.S.];
- Setting parameters regarding their duties relative to those of the agency they advise or oversee [Section 24-3.7-102(1)(f). C.R.S.];

- Ensuring they are appropriately involved in key communications and policymaking activities [Section 24-3.7-102(1)(h), C.R.S.]; and
- Ensuring members act in accordance with their roles as public representatives [Section 24-3.7-102(1)(i), C.R.S.].

Statute also states that the state agency responsible for a commission shall ensure that the “commission obtains the annual training and implements the written policies specified in subsection (1) of this section” [Section 24-3.7-102(2), C.R.S.].

The Commission adopted its *Commission Procedures* in 2018, which state that the Commission’s purpose is to “[e]nsure compliance with C.R.S. 24-3.7-102, which requires annual training of all Colorado boards and commissions to ensure members act in accordance with their roles as public representatives.” It then lists the best practices from that section of statute such as those in the bullets above without further elaboration. The procedures, do not provide guidance on how the Commission should go about fulfilling its responsibilities. For example, the procedures do not provide detail on the Commission’s role in oversight of lottery projects, the Commission’s duties relative to Lottery management’s duties, or what the Commission’s role is in reviewing the Lottery’s communication and policy-making activities. Additionally, the Lottery created the *Commissioner Handbook*, which was also adopted in 2018, and was created to provide Commissioners with a general orientation to the Lottery. Although the handbook lists Commission duties, it does not explain how those duties should be fulfilled. For example, it includes copies of the Lottery statutes, a flow chart of the rulemaking process from the Secretary of State’s Office, the open meetings statutes, the open records statutes, and Department policies on media and social media. However, it does not have procedures on how the Commission should carry out the duties that are included in the statutes, such as how to conduct debate and rule making for Lottery operations. Providing information of this sort could help Commission members better understand their role and the expectations around it. For example, the *Board Member Orientation Manual* from the Department of Regulatory Agencies provides board members with procedures for dealing with complaint hearings, how to follow Robert’s Rules of Order in their proceedings, and details on the rulemaking process including the circumstances requiring the need for formal rulemaking hearings.

In addition, it appears that the information that the Lottery provides to the Commission prior to the monthly meetings on the topics that will be discussed is limited. We reviewed the information packets that the Lottery provided to the Commission for 10 meetings that occurred during Fiscal Years 2020 through 2022, including meetings where the Lottery discussed the benefits of allowing courier services with the Commission. The December 2019 meeting information packet included the item listed on the agenda as part of the Director’s Report but did not include background information on the topic or that this was to be a decision item.

Further, our review of Commission meeting minutes from Fiscal Years 2020 through 2022 showed that the Lottery and a representative from the Attorney General’s Office provided members with an annual best practices and ethics training. The audit team attended the annual training provided in March 2023, at which the Lottery and a representative from the Attorney General’s Office provided a PowerPoint presentation to the Commission. The slide deck contained the statutes and rules that apply to the Commission and what duties are outlined in those statutes, but it did not provide practical policies or procedures to guide Commissioners on how to fulfill their duties, mainly because clearly defined policies and procedures had yet to be created. According to four of the Commissioners that we interviewed, they did not recall receiving a formal orientation or training from the Lottery that explained how to fulfill their responsibilities as Commissioners. Instead, Commissioners reported that they rely on the expertise of more senior members of the Commission or are told by the Lottery to ask questions if they have any.

“According to four of the Commissioners that we interviewed, they did not recall receiving a formal orientation or training from the Lottery that explained how to fulfill their responsibilities as Commissioners.”

The Lottery and Commission could make better use of available communication tools to engage the public and encourage participation. The Lottery does not leverage its social media presence to help make the public aware of meetings, but instead uses it as purely a marketing tool. Neither the Lottery nor the Commission have established policies or procedures related to communicating information to the public on the date and time of Commission meetings through various communication tools, including social media. We looked at the public feeds of the Lottery’s Twitter and Facebook accounts and found that Commission meetings were never announced on social media posts, nor were the significant operational changes mentioned. With the changes in operations mentioned above, it is perhaps more important than ever for the Lottery to take steps to help ensure that members of the public are aware of potential changes and have an opportunity to provide feedback.

Why do these problems matter?

The Commission was established to provide oversight and governance of the Lottery and the State on how to operate the Lottery to ensure the integrity of its games and the organization. When the Commissioners do not have a clear understanding of their roles and responsibilities, they are not able to fulfill their purpose. Additionally, the lack of detailed policies and training on the role of the Commission has resulted in neither the Lottery nor the Commission knowing how to leverage the expertise that is required by statute for three of its members. Statute specifies that individuals with backgrounds including in law enforcement, as a lawyer, and as a CPA, must be appointed to the Commission. It is reasonable to assume these individuals are on the Commission to have particular roles in the decision-making process. However, those roles are not detailed in policy to inform how their positions should be used.

Over the past few years, the Lottery has undergone some changes to the model in which it operates, and likely more changes are to come. Many of these changes, such as licensing retailers who sell to online couriers and implementing electronic claims, include new technology and methods of commerce that have come about since the Lottery was created 41 years ago. Furthermore, the Lottery reported that it is considering selling tickets online at some point in the future. It would stand to reason that the Commission is the body that was put in place with the required expertise to consider these matters and they need sufficient guidance and information on how to fulfill this responsibility. Lastly, while management does seek involvement from the public in exercises such as its tracking studies, the technology has also evolved to allow for more public outreach, engagement, and involvement in Commission hearings when considering these and other future changes.

Recommendation 2

The Lottery Commission (Commission) should work with the Colorado Lottery (Lottery) to ensure that the Commission is able to effectively fulfill its statutory duty to oversee Lottery operations by:

- A. Establishing and implementing written policies and procedures that are consistent with the best practices established in statute for boards and commissions and that, at a minimum, clearly define the roles of the Commissioners and how the Commission should operate to meet its statutory obligations.
- B. Updating the training program for new Commissioners and annual best practices and ethics training for established Commissioners to include training on the policies and procedures implemented in part A.
- C. Developing procedures for how to engage with the public in Commission business by using outlets such as social media to announce Commission meetings and how to encourage public participation in them.

Response

Colorado Lottery and Lottery Commission

- A. Agree
Implementation Date: June 2024

The Colorado Lottery and the Commission will work with legal counsel and the Department of Revenue (“Department”) to establish and implement written policies and procedures that are consistent with best practices established for boards and commissions and, at a minimum, clearly define the roles of the Commissioners and how the Commission should operate to meet its statutory obligations.

B. Agree

Implementation Date: June 2024

The Lottery and the Commission will work with legal counsel to update its training program for new Commissioners and update the annual best practices and ethics training to include training on the written policies and procedures that are implemented in response to part A.

C. Agree

Implementation Date: June 2024

The Lottery and the Commission will work with the Department of Revenue to develop procedures for engaging with the public regarding Commission business by using outlets such as social media to announce Commission meetings and encourage public participation in them.

Finding 3—Retailer Compliance Certifications

The Lottery Director is statutorily responsible for supervising lottery operations and taking “any action that may be necessary to protect the security and integrity of the lottery games.” [Section 44-40-104(4), C.R.S.] Supervision of Lottery operations includes a variety of tasks, such as the Director approving the licensing of suitable retailers and Lottery staff taking steps to ensure retailers follow rules and requirements. The Commission has adopted rules for Lottery operations, including requirements for retailers related to ensuring the security and integrity of their own Lottery activities. These rules include a general statement that “In order to promote the public interest and the security and efficient operation of the Lottery, each applicant shall agree, if granted a license, to perform the following terms, conditions and duties . . . to be bound by and comply with all lawful provisions of Article 40, Title 44, C.R.S. and the Rules and Regulations adopted pursuant thereto; as well as with any lawful instructions or directives issued by the Director.” [1 CCR 206-1, Rule 2.4(a)]. The rules go on to list specific retailer duties that range from how to store Lottery tickets, to how to pay prizes, and what signage must be displayed [1 CCR 206-1, Rule 2.4]

The responsibilities of the Lottery’s security/investigations unit include security of retailer operations as they relate to Lottery products. Historically, this unit conducted onsite inspections of a sample of retailers each year to verify compliance with rules and requirements, particularly those that pertain to Lottery security and integrity. In 2020, the Lottery discontinued this practice due to the Pandemic and began requiring retailers to complete an annual online Retailer Compliance Certification (Certification). The Certification asks retailers to answer questions about how they store, sell, and promote Lottery products. Compliance investigators in the security/investigations unit review the completed Certifications to assess each retailer’s compliance with the rules, and call retailers that are not in compliance to inform them of the requirements and ask them to rectify the situation. For instance, if a retailer reports that they store tickets in an unlocked cabinet, the investigator will tell them that the tickets need to be stored in a locked and secure area, and asks them to confirm that the tickets have been moved and stored accordingly.

The Lottery notified retailers about the Compliance Certification requirement by letter in June 2020, and instructed them that “The online Retailer Compliance Certification form should be completed by an owner, bookkeeper or a member of management.” In addition, the Lottery sent each retailer a second letter providing instructions on how to navigate the online system to submit their Certifications or allowing them to call Lottery compliance staff if they prefer to provide information over the phone.

What audit work was performed and what was the purpose?

We reviewed statutes and rules governing the security and integrity of Lottery operations, including the requirements for holding a retailer license, as well as the Lottery’s policy manual for compliance investigations. We analyzed data provided by the Lottery indicating which retailers had submitted their Certifications for Calendar Years 2021 and 2022. The purpose of the audit work was to determine if the Lottery was collecting and reviewing Certifications as part of its efforts to supervise Lottery operations and protect the security and integrity of lottery games, as required by statute.

How were the results of the audit work measured?

Statute charges the director of the Lottery to “take any action that may be necessary to protect the security and integrity of the lottery games.” [Section 44-40-104(4), C.R.S.] As noted previously, one tool the Lottery uses to help fulfill this charge is the Certification completed by retailers and reviewed by Lottery security staff. According to the Lottery’s Compliance Investigations Policy, licensed retailers are required to submit a Certification annually. Licensees are sent a letter 60 days before their license renewal date each year with instructions on completing the Certification, which is due within 30 days of the date on the letter. The Certification provides the Lottery with basic, self-reported, information about the retailer’s measures for protecting the security and integrity of lottery products, including:

- Whether the retailer has a security system with working video cameras.
- Where scratch tickets and jackpot ticket paper are stored. Rules require licensees to “maintain a secure place for unsold Lottery products.” [1 CCR 206-1, Rule 2.4(l)].
- When inventory of scratch tickets is conducted.
- Whether the retailer has a properly working display for validating tickets that is visible to the public.
- Which employee activates the scratch tickets for sale.

The form also asks the retailer to provide a serial number from the jackpot ticket paper currently in use. Rules require licensees to print jackpot tickets only on “the specific ticket stock issued by the Lottery to the specific retail outlet and not transfer ticket stock to any other outlet.” [1 CCR 206-1, Rule 2.4 (w)(1)]. Finally, the form includes a statement with a box that must be checked before the form can be submitted stating “By submitting this form, I acknowledge that the information

provided is correct and accurate as required by the Lottery retailer rules and regulations 1 CCR 206-1 and C.R.S. 44-40-107 and 44-40-109 (1)(a) and (2).”

What problem did the audit work identify?

We found that the Lottery is not consistently obtaining Certifications from retailers each year. Specifically, for Calendar Years 2021 and 2022, the Lottery did not obtain Certifications from roughly 40 percent of its licensed retailers each year, as shown in Exhibit 2.4.

Exhibit 2.4 Number of Missing Retailer Compliance Certifications Calendar Years 2021 and 2022

	2021	2022
Total Required Retailer Compliance Certifications ¹	2,741	2,810
Retailers That Did Not Submit Certifications	1,126	1,079
Percent of Missing Certifications	41%	38%

Source: Office of the State Auditor analysis of retail sales and compliance certification data for Calendar Years 2021 and 2022.

¹ The number of retailers that held active licenses and sold tickets the entire year in Calendar Years 2021 and 2022.

Why did this problem occur?

The Lottery is not using all of the tools available to encourage and enforce the submission of Certifications by retailers. In particular, the Lottery does not use its Lottery sales agents to bolster communication about the Certification process and it does not take enforcement actions when retailers fail to file Certifications. Both of these issues are discussed below.

First, compliance staff told us that implementing the Certification process has been challenging because retailers are not always responsive to Lottery communications. They said that retailers do not always check mail or email, so the messaging about the process may not have been seen by some retailers. The Lottery’s most consistent method of contact with retailers is through its Lottery sales agents, who visit each retailer every 2 weeks. When the Lottery first rolled out its online compliance form system, it utilized the Lottery’s “Retailer Connection” newsletter to communicate the new system to retailers. These newsletters are delivered to retailers by the Lottery sales agents. However, the Lottery has not established practices (1) for sales agents to generally educate or remind retailers about the Certification process or (2) for compliance staff to coordinate with sales agents about retailers who are late in filing, so the sales agents can target communication to retailers that have not filed.

Second, although rules specify actions the Lottery can take when retailers are out of compliance with any Lottery requirement, the Lottery does not use them to enforce the Certification requirement.

For example, when retailers apply to renew their licenses each year, the Lottery does not consider whether the retailer has submitted their Certification, or whether the retailer was deemed compliant, before approving their renewal. Making the submission of the Certification a condition of renewal would be consistent with the requirement that, in order to be licensed, a retailer must agree to adhere to all rules and directives. Another option to help ensure compliance with the Certification requirement would be for the Lottery to suspend a retailer's Lottery operations. Lottery Rule 2.7(b)(1) states "The Director may immediately suspend a retailer's Lottery operation, order removal of an online terminal from a retail location, or take any other action necessary in the event the licensee ... fails to comply with any rule established by the Commission or any instruction issued by the Director." [1 CCR 206-1]

According to the Lottery, it has not revoked retailer licenses for retailers' failure to submit a Certification because the Lottery's preference is to not immediately move to revocation but to try to work with the business owner to bring them into compliance as there is more of a partnership between the Lottery and its retailers rather than a regulatory model. According to the Lottery, they are often successful in bringing the retailers into compliance or if not, having the retailer voluntarily relinquish their license. However, it is also important that the Lottery maintain its integrity and security, and additional enforcement actions may be needed if a retailer repeatedly fails to file their Certification.

Why does this problem matter?

The Lottery's assurance that licensed retailers are following Lottery rules and keeping tickets safe has been impacted negatively with the implementation of the online Certification process. Although the Certification process was established as a means of oversight during the Pandemic, the Lottery anticipated that it would provide a more expansive picture of retailer compliance, because all retailers were required to file a Certification form. Before the transition to this process in 2020, the Lottery's two compliance investigators were only able to complete on-site compliance inspections of fewer than half of the licensed retailers each year. For example, between 2017 and 2019, the Lottery inspected only about 44 percent of retailers each year. Although the Certification process has resulted in the Lottery collecting compliance information from more retailers, the 60 percent response rate from retailers in 2021 and 2022 was lower than anticipated. Further, because the Certification form only includes self-reported information provided by the retailer, there is a higher risk that the information provided may not be accurate. Although Lottery rules state that on-site inspections may occur, the Lottery reported that as of June 2020, the only on-site inspections or investigations conducted have been in response to criminal cases or part of their sting operations, which evaluate the retailer's claims process.

Without a more robust system to help ensure that retailers follow rules, especially those related to Lottery security and integrity, the Lottery is not fully accomplishing its responsibility to supervise

Lottery activities, as outlined in statute. [Sections 44-40-103 & 104(4)(a), C.R.S.] The Certification focuses on retailer measures for ensuring Lottery transactions are secure and lawful. For example:

- Storing scratch tickets and jackpot paper in secure locations helps prevent them from being stolen.
- Having working video security can both deter and help solve a theft of Lottery products.
- Taking inventory can ensure that when tickets are stolen, the exact numbers of the stolen tickets can be reported to the Lottery immediately, which can help identify suspects and prevent the validation of stolen tickets and prevent prizes from being claimed.
- Having operational Lottery machines ensures that the interface with the gaming system is working to track the sale of tickets.
- Having working Lottery terminal displays allows customers to verify whether a ticket is a winner and the amount of the prize.
- Properly activating tickets provides a safeguard against having too many tickets—while valid for claiming a winning prize—at risk of being stolen and decreases the retailer’s financial exposure in case of theft.

If retailers have inadequate measures in these areas, and the Lottery is unaware of it because of gaps in its oversight, the Lottery is not thoroughly fulfilling its duty.

Recommendation 3

The Colorado Lottery (Lottery) should implement practices to improve retailer compliance with the Retailer Compliance Certification (Certification) process, including:

- A. Using Lottery sales agents to educate or remind retailers about the Certification process and to target communication to retailers that do not file their Certifications as required.
- B. Taking enforcement action when retailers do not file their Certifications, which could include denying or delaying license renewal, or otherwise suspending operations, of a retailer until their required Certification has been submitted.

Response

Colorado Lottery

A. Agree

Implementation Date: June 2024

The Lottery will incorporate training on how to educate and remind retailers about compliance into the sales agents' regular sales training and utilize sales agents to do visual checks to verify that a retailer has addressed issues of non-compliance at retail locations.

B. Agree

Implementation Date: June 2024

The Colorado Lottery will review its compliance program and create policies and procedures that will guide enforcement actions against retailers, including denying or delaying license renewal or otherwise suspending operations, for non-compliance with the Lottery's retailer agreement and rules. The Lottery will also ensure its compliance and licensing teams are coordinating and sharing information to ensure that licenses are not renewed when the policies and procedures require non-renewal due to a lack of compliance.

Finding 4—Restricted Player Database

To help maintain public confidence and trust in the Lottery's games, individuals who may have detailed knowledge of Lottery operations are restricted from purchasing lottery tickets or winning prizes. These individuals, deemed "restricted players," include Lottery Commissioners, Lottery employees, key personnel of some Lottery vendors, and the immediate family members of these individuals. If these individuals were to win large prizes, it could create the public perception that the Lottery's games are not fair and that these individuals are able to use inside information to manipulate the games.

Although the Lottery cannot prevent these individuals from purchasing lottery tickets, it can prevent them from claiming higher dollar prizes. The Lottery maintains a restricted player database (database) that includes information for all of the individuals who are restricted from purchasing lottery tickets and winning prizes. When an individual submits a claim for a prize more than \$599, they have to provide personally identifiable information to the Lottery in order to claim the prize. These individuals are automatically checked by the Lottery's claims system against the information in the database to verify that the individual is not in the database and restricted from playing the lottery prior to paying out the prize. If the individual's name is in the database, they will not receive the prize payout. The database would not prevent restricted players from claiming prizes less than \$599 because no personally identifiable information is required to claim these lower-tier prizes.

Lottery policies require each lottery employee to complete a “Restricted Player Database Agreement” (Agreement) each year. The Agreement collects first, middle, and last name; last four digits of their social security number; and date of birth for the employee and the employee’s immediate family members who live with them. Lottery staff enter this information into the database. The Lottery also requires its employees to notify Lottery management immediately if their situations change, such as when there is a change in the family members living in their households.

What audit work was performed and what was the purpose?

We reviewed statutes and Lottery rules, policies, and procedures related to the restricted player database and data retention policies. We also reviewed the Lottery’s “Conflicts of Interest & Restricted Player Database Procedure” manual, which is provided to Lottery Commissioners and employees, and provides information on the requirement that they fill out the Agreement and informs them that any violation of the policy of not playing or claiming a Lottery prize can result in disciplinary action. We then compared the database, as of February 2023, to a list of Lottery Commissioners and employees as of that date, to determine if all of them were included in the database. As we were limited in determining the household members of Commissioners and staff, we were not able to verify if all of them were included.

The purpose of our audit work was to evaluate the effectiveness of the Lottery’s restricted player database in ensuring that restricted players do not claim lottery prizes, in accordance with statutory and regulatory requirements.

How were the results of the audit work measured?

Statute [Section 44-40-110(1)(c), C.R.S.] and Lottery rules [1 CCR 206-1, 1.3.3, B] prohibit Commission members, Lottery employees, and their immediate families, from purchasing any ticket from the Colorado Lottery and specifies that these individuals are not eligible to receive any lottery prize. Lottery policy requires all lottery employees, at the time of hire and annually thereafter, to complete and submit the Agreement but does not include a date by which they must submit it.

Colorado State Controller policy requires all executive branch agencies to follow the Standards for Internal Control in the Federal Government (Green Book). One of the key principles of the Green Book is that management of an organization is responsible for implementing controls to achieve the organization’s mission and goals and to comply with laws and regulations. It notes that “in the government sector, objectives related to compliance with applicable laws and regulations are very significant” [OV2.22]. The Green Book also lays out specific requirements, one of which is that “management should implement control activities through policies.” [Principle 12]. In line with the Green Book standards, the Lottery has a responsibility to implement effective controls to prevent employees and Commissioners from violating the restrictions on playing and winning.

What problem did the audit work identify and why did the problem occur?

Overall, we found that the Lottery's restricted player database may not be effective in preventing restricted players from receiving higher-dollar prizes. Specifically, we found that when we received the database from Lottery in February 2023, 23 of the Lottery's 94 staff (25 percent) employed at that time were not included in the database. The database included 71 lottery employees and 76 household members of those employees. Those not entered into the database included the Lottery's Senior Director, Director of Sales, and two managers. There were also no household members included for the 23 missing Lottery employees.

According to the Lottery, Lottery staff load the information from the Agreements into a file that they then provide to the gaming system vendor to upload into the system as a batch file. When the vendor uploads the file, the previous names and associated information is deleted. If the update is made prior to the Security Division receiving all of the Agreements, those who are missing will be wiped from the file. The Lottery also destroys the Agreements themselves after the information is uploaded in order to protect personally identifying information; as a result, the Lottery does not maintain a record of the data. However, the policy does not specifically state that Lottery Commissioners must submit the Agreement each year and there are no timelines or deadlines for when Commissioners and employees are required to submit their annual Agreements or for when Lottery staff are required to enter information from the Agreements into the database. Our 2018 performance audit of the Lottery included recommendations to the Lottery related to improving its management of the restricted player database because the audit also found that the information in the database was incomplete. The Lottery agreed with the recommendations and reported to the OSA in September 2019 that it had "adopted a new procedure requiring Lottery employees and Commissioners to complete a Restricted Player Form within 30 days of their start date and further requires that the Lottery enter the information into the Restricted Player Database within 60 days of receipt." The Lottery's current policy related to its restricted player database no longer includes the 30-and 60-day deadlines that were implemented in response to the audit recommendation.

In addition, the Lottery's policies do not specify a standard time during the year when all existing Lottery Commissioners and employees must submit their annual Agreement, such as by January 1st each year; these Agreements could come in at any point during the year. As a result, there could be months during the year when a restricted employee's information is not included in the database. For example, if the Lottery deletes all of the information in the database in January, and an employee does not submit their Agreement until October of that year, this individual's information would not be included in the database for about 10 months of the year. During these 10 months, the employee and their immediate family members could potentially be able to claim lottery prizes because their names would not be flagged by the database.

Requiring all Lottery Commissioners and employees to submit their annual Agreements by a specific deadline would help prevent gaps in the database because all of the information could be updated at one time. It would also make the process for updating the database more efficient because rather than deleting all of the information in the database and having to reenter it, Lottery staff could go through the database and update the information as needed based on the new Agreements. Maintaining information in the database would also prevent issues with individuals being deleted from the database after they purchase a ticket but before they claim a prize because prizes can be claimed up to 180 days after a drawing or at the end of a scratch game.

Why does this problem matter?

When the Lottery does not ensure that the database is complete and current, there is a risk that restricted players will purchase lottery tickets and claim higher-dollar prizes, which could negatively affect the public's perception of the Lottery. The mission of the Lottery is to create and sell "games of chance that are held to the highest standards of integrity, entertainment, and efficiency, in order to maximize proceeds for the people of Colorado." Lottery proceeds go to designated recipients, primarily for outdoor conservation and preservation: Great Outdoors Colorado (with excess funds going toward school infrastructure improvements), Conservation Trust Fund, and Colorado Parks and Wildlife. In Fiscal Year 2022, players spent nearly \$827 million on lottery games in Colorado, of which over \$180 million went to proceed recipients. If the public loses trust in the Lottery, and does not have confidence in the integrity and fairness of the games, it could impact lottery ticket sales, which would reduce the amount of revenue available for beneficiaries.

Recommendation 4

The Colorado Lottery (Lottery) should improve the effectiveness of its controls to prevent restricted players from receiving higher-dollar prizes by:

- A. Revising its written policies and procedures to establish requirements and deadlines for Lottery Commissioners and employees to complete and submit their Restricted Player Database (database) Agreements (Agreements), both at the time of hire or appointment and each year thereafter. This should include establishing a standard timeframe for all existing Lottery Commissioners and employees to submit their updated Agreement at the same time each year.
- B. Revising its written policies and procedures to establish a timeframe for Lottery staff to enter information from the Agreements into the restricted player database once they have been received.
- C. Revising its approach to updating the restricted player database so that only the outdated information is removed from the database each year, rather than all of the information.

Response

Colorado Lottery

A. Agree

Implementation Date: January 2024

The Colorado Lottery will revise its written policies and procedures to establish requirements and deadlines for Lottery Commissioners and employees to complete and submit their Restricted Player Database Agreements (Agreements), both at the time of hire or appointment and each year thereafter. This will include establishing a standard timeframe for all existing Commissioners and employees to submit their updated Agreement at the same time each year.

B. Agree

Implementation Date: January 2024

The Colorado Lottery will revise its written policies and procedures to establish a timeframe for updating the information in the restricted player database to ensure that new information is entered in a timely manner when new Agreements are received. The policies and procedures will also require a staff member to periodically review the database to ensure it contains all current staff and Commissioners.

C. Agree

Implementation Date: June 2024

The Colorado Lottery will explore and identify ways to make the process of updating the Restricted Player Database (“RPD”) more efficient, including working with the current vendor and seeking system solutions in the Lottery Revenue Generation Solution solicitation, happening now, to improve the process for updating RPD information.

Finding 5—Unusual Winning Patterns Analysis

The Lottery provides a variety of games that are all based on a random chance of winning. The odds of winning the scratch game products vary based upon the game design. However, jackpot games are random number drawings, which by their nature have consistent odds of winning for every drawing for a particular game, though the odds can differ by game based on the numbers available for players to select from and how many numbers are drawn.

Historically, players have been able to claim any prize of \$599 and under in-person at a lottery retailer or at one of the Lottery’s four claims offices, or through the mail by sending in a signed winning ticket to the Lottery. Prizes of \$600 and over have had to be claimed directly from the Lottery, either in-person at one of the Lottery’s claims offices or through the mail. As of October

2021, players can now also claim prizes over \$600 but under \$100,000 via a form submitted to the Lottery via secured electronic envelope (i.e., a secure file transfer).

Prizes over \$599 require the winner to submit a completed physical claim form through mail or in person or an electronic form through the internet, to the Lottery that provides information including the player's name, address, and social security number. Lottery staff enter this information into the Lottery's gaming system, which tracks where tickets are sold, when they are sold, and data on winning tickets. The OSA's 2018 *Lottery Performance Audit* report identified winners who had won high-tier prizes a seemingly unusual number of times, including 10 people who won 15 or more times in a 3-year period, which included the owner of a Lottery retailer who claimed 24 prizes of \$600 or more during that period. We recommended that the Lottery implement policies to regularly analyze claims data for unusual winning patterns and make further inquiries if the odds of making such claims rise to a level of suspicion. The Lottery agreed with the audit recommendation and reported that it would begin running a report each quarter to identify individuals who have claimed multiple prizes over \$599 during that quarter and establish thresholds that would trigger investigations into any that appeared questionable.

What was the purpose of the audit work and what work was performed?

The purpose of our audit work was to follow up on the implementation status of our 2018 recommendation to routinely analyze data of unusual winning patterns and establish thresholds to trigger further inquiry into those instances where someone has won more frequently than the odds of winning each game would suggest is possible in order to verify the validity of those wins.

We reviewed Lottery policies and procedures created in response to the recommendation for identifying and investigating individuals who claim multiple high-tier prizes. We also reviewed and analyzed the quarterly data reports produced by the Lottery for Fiscal Years 2020 through 2022 identifying individuals who claimed multiple high-tier prizes to identify individuals who have claimed multiple high-tier prizes across the quarters, and requested Lottery documentation related to any investigations that it had conducted into these individuals. We then asked the Lottery for information on any individuals who warranted further investigation, and documentation of any investigation conducted into their claims.

How were the results of the audit work measured?

The Lottery has a fundamental duty to ensure that its games are operated in a legal and ethical manner. First, statute charges the director of the Lottery to "take any action that may be necessary to protect the security and integrity of the lottery games." [Section 44-40-104(4), C.R.S.]. To that end, according to the Lottery's website, "[t]he public must have complete faith, trust and confidence in our games to ensure that everyone that plays has an equal and fair chance of winning," which is the

purpose of its security operations. Additionally, the Lottery states that it strives “to establish a true partnership with employees, customers and regulatory agencies to ensure the highest level of integrity with our products and vendors.”

One way the Lottery fulfills this duty is through a written procedure to identify and investigate “multiple winners.” The procedure states: “On a quarterly basis, the [multiple winner] reports specified below will be generated and reviewed by the Investigations and Security section.”

- Retail owner or retail employee. The report will cover a rolling 1-year period, include all claims of at least \$600 each, and include all Lottery products.
- Regular player. The report will cover a rolling 1-year period, include all claims of at least \$600, and include all manual-entry Jackpot games.; for manual-entry Jackpot games, players manually select their numbers rather than using the “quick pick” function where the lottery machine randomly selects number for them.

The procedure goes on to state that, if a report shows that a player made three or more claims of at least \$600 each during the report period, the Investigations and Security section “shall conduct a more in-depth review to determine if reasonable suspicion exists to open an investigation” into that player.

Colorado Office of the State Controller (OSC) policy requires all executive branch agencies to follow the *Standards for Internal Control in the Federal Government* (Green Book). One of the key principles of the Green Book is that management of an organization is responsible for implementing controls to achieve the organization’s mission and goals and to comply with laws and regulations. It notes that “in the government sector, objectives related to compliance with applicable laws and regulations are very significant” [OV2.22]. The Green Book also lays out specific requirements, one of which is that “management should implement control activities through policies.” [Principle 12].

What problem did the audit work identify?

Overall, we found that while the Lottery created a policy requiring staff to pull the data that comprise the quarterly reports to identify individuals with multiple high-tier prize wins each quarter and to investigate any incidents that raise a reasonable suspicion, there was no documentation that Lottery staff investigated any of the unusual winning patterns identified within those reports or how they made a determination that there was not suspicion to open an investigation. Our analysis of the multiple winner reports that the Lottery pulled for each quarter during Fiscal Years 2020 through 2022 identified 70 winners with 3 or more winning claims of at least \$600 each in a given year. We identified 5 individuals with 10 or more wins in a given *quarter*, which according to policy should have been further examined to determine if an in-depth investigation was warranted. One winner claimed 44 prizes totaling \$38,500 in a single quarter in Fiscal Year 2022. One retailer made 10

claims totaling \$14,900 in a single quarter; this is the same retailer reported on in our 2018 audit report who, at that time, had 24 wins of \$600 or more over a 3-year period totaling \$39,750. However, Lottery reported that they did not conduct any further investigation into these players. Exhibit 2.5 shows the number of players who claimed three or more prizes of \$600 or more in each quarter during Fiscal Years 2020 through 2022.

Exhibit 2.5
Number of Players with More Than Three Claims in a Quarter
Fiscal Years 2020 through 2022

Number of Wins	Fiscal Year 2020				Fiscal Year 2021				Fiscal Year 2022			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
3-9	8	7	4	8	6	10	6	9	19	8	7	5
10-19	1					1						
20+					1						1	

Source: Office of the State Auditor analysis of Fiscal Years 2020 through 2022 quarterly reports provided by the Lottery.

Some players claimed three or more high-tier prizes in more than one quarter of each year. Exhibit 2.6 shows how many players had multiple wins in 2 or 3 quarters of each year; no players won three or more times in all 4 quarters of a year.

Exhibit 2.6
Number of Players with More Than Three High-Tier Claims in Multiple Quarters During a Year
Fiscal Years 2020 through 2022

	Fiscal Year 2020	Fiscal Year 2021	Fiscal Year 2022
Won in 2 Quarters	7	6	6
Won in 3 Quarters	3	5	5

Source: Office of the State Auditor analysis of Fiscal Years 2020 through 2022 quarterly reports provided by the Lottery.

Why did this problem occur?

The issues that we cite occurred because it is not clear that Lottery management believe that the individuals we identified rose to a level of suspicion that would require them to perform an investigation. The Lottery reported that it did review the data in the reports, but did not find reasonable suspicion to warrant further investigation. Reasons the Lottery said they would not think there was reasonable suspicion include instances in which they find that there were multiple wins on the same wager, it was a quick pick instead of a self-pick ticket, which is inherently less suspicious because the terminal generates the numbers randomly. In addition, the Lottery might determine there was not reasonable suspicion requiring investigation because the game that was won had very

low odds (for example, Pick 3's odds are 1 in 333). However, there may be other reasons that an individual wins multiple times that could potentially raise into question the Lottery's integrity.

The Lottery has not established a standard, documented process for reviewing the quarterly reports that it produces showing winners with multiple high-tier wins in order to identify any requiring further investigation. According to the Lottery, it believes that none of the individuals with multiple high-tier wins since the beginning of our testing period in Fiscal Year 2020 have risen to a level of suspicion that indicated the need for further examination or investigation. This includes the individual who submitted 44 winning claims totaling \$38,500 during one quarter of the review period. However, the Lottery does not have documentation to support which factors it considered when making this determination. Additionally, the Lottery has not established written criteria for staff to apply when reviewing the quarterly reports and deciding whether an investigation is needed. For example, the criteria could include identifying any players with a higher number of claims than what would be considered in a normal range, which could be a trigger for conducting an investigation. The player who submitted 44 winning claims of \$600 or more during one quarter would be an example of a player that appears to be outside of the normal range. Similarly, a player who submits a high number of claims over multiple years could also be a trigger for conducting an investigation. For instance, one player submitted four or more claims in each of the years reviewed—including 11 in Fiscal Year 2022; this individual also happens to be a lottery retailer—the same individual that we identified in our 2018 performance audit as submitting an unusual number of winning claims. According to the Lottery, it is not unusual for retail owners to have multiple winning claims, as they spend a lot of time in the stores and play often.

Why does this problem matter?

When the Lottery does not identify, consider, and investigate unusual patterns in winning claims, there is a risk that some individuals, including licensed lottery retailers, may be claiming prizes through a process that circumvents the randomness of the games, or acting in a way that portrays the Lottery and the integrity of its games in a negative light. In addition, there is a practice known as “discounting” that can occur with lotteries as a way for some prize winners to avoid intercepts or to launder money. Discounting occurs when a person who owes child support, back taxes, or court fines and fees that will be intercepted if they claim a high-tier prize, sells the ticket to another individual at less than the prize value, and then the second person claims the prize for the full amount. In a recent case in Massachusetts, the IRS uncovered a discounting scam that occurred from 2011 through 2020, in which two individuals were purchasing winning tickets from other individuals at a discount and then claiming the prizes for themselves in order for the actual winners to circumvent the prize intercept process. The two individuals running the discounting scam were also able to use the perception of their frequency of winning as an indication of frequent play in order to claim a tax credit for gambling losses. In total, these two individuals submitted \$20 million in claims to the Massachusetts Lottery over the 9-year period. While discounting is not specifically illegal in Colorado, it could violate statutes concerning the tax evasion and payment of child support

or outstanding debts to the State. When an individual submits multiple high-tier claims in a short period of time, or routinely from one year to the next, it could potentially indicate that a discounting scheme is occurring.

Additionally, Lottery staff reported that the reason that some individuals have won so frequently is because they play the Lottery often and spend a significant amount of money on lottery tickets each week. If this is occurring and is the reason for some of the high-tier winners with multiple claims each year, this could be an indicator that these individuals have a gambling problem. The Lottery's website states the following: "The Colorado Lottery's Commitment to Players. The Colorado Lottery and its employees have pledged to make responsible gaming an integral part of how we conduct our business." Investigating individuals with multiple winning claims could be a means for the Lottery to identify those individuals with gambling problems who might need support or resources, which would help the Lottery achieve its goal of responsible gaming.

Recommendation 5

The Colorado Lottery (Lottery) should ensure that it helps protect the integrity of the State's lottery program by revising its policy for reviewing and investigating individuals who claim multiple high-tier prizes within a specified time period. This should include revising the criteria for staff to apply to identify any winners requiring further investigation to more closely align with exactly what type of winning patterns the Lottery deems to be high risk; establishing a standard, documented process for reviewing the quarterly reports that it produces showing winners with multiple high-tier wins; and adding a requirement in policy that staff document their assessment of the winners and reasons for deciding that someone meeting the criteria should or should not be investigated further.

Response

Colorado Lottery

Agree

Implementation Date: January 2024

The Colorado Lottery will revise its policy for reviewing and investigating individuals who claim multiple high-tier prizes, including: revising the criteria for staff to apply when identifying winners requiring further investigation to more closely align with exactly what type of winning patterns the Lottery deems to be high risk; establishing a standard, documented process for reviewing the quarterly reports showing winners with multiple high-tier wins; and a requirement in policy that staff document the assessment of the winners and reasons for determining when a situation warrants further investigation.

Finding 6—Advertising Services Contracting Process

The Department of Revenue (Department) has a Purchasing and Contracts Section that organizes and oversees all procurement in the Department, including for the Lottery. The Lottery contracts with vendors for a variety of services. In this section, we discuss our review of the Lottery’s processes to procure advertising services and a gambling prevalence study.

Advertising Services

The Lottery most recently issued a Request for Proposals for advertising services in September 2021 and awarded the contract to Cactus Communications, Inc. (Cactus). The contract has an initial 1-year term for Fiscal Year 2023 at a cost of about \$11.2 million and includes options for the Lottery to extend the contract term annually for up to 7 years at \$13.7 million per year for a maximum total contract amount of about \$107.1 million. The Lottery has used this same vendor, Cactus, for its advertising services for 16 years. Prior to the most recent award in 2022, the Lottery started its previous contract with Cactus for advertising services in May 2017—that contract had an initial term of 3 years with two additional 1-year options, each at nearly \$15 million (which Lottery exercised), for a total contract amount of nearly \$75 million.

The Lottery’s advertising services contract includes the following services:

- Development of media plans
- Negotiation and purchase of media time and space
- Distribution to media outlets of any advertising materials
- Verification of publication and broadcasting of advertising materials
- Analysis of performance of advertising campaigns

The Lottery’s selection process for awarding its Fiscal Year 2023 advertising services contract consisted of two phases. The first included an assessment of the proposals that offerors submitted in response to the RFP using the following four factors and weighting:

- (1) Experience and Qualifications—30 percent
- (2) Advertising and Client Services—30 percent
- (3) Cost—25 percent
- (4) Business Problem Solution—15 percent

The second phase of the selection process included a visit by Lottery and Department staff to the offices of the offerors “whose proposals . . . are deemed reasonably susceptible of being selected for an award,” for a presentation on their marketing vision. The selection committee consisted of four Lottery employees and one non-employee as well as a member of the Department’s Purchasing and Contracting Section who oversaw the process but was not involved in the decision making. Four

offerors submitted proposals for the Lottery’s advertising services contract, and the selection committee selected three to visit during the second phase of the process.

Gambling Prevalence Study

In Fiscal Year 2021, the Lottery sought to have a gambling prevalence study done “to determine current baseline measures of the prevalence of gambling and problem gambling for Colorado adults, age 18 and older,” and to help support the Lottery’s application to the World Lottery Association for a Level 4 Responsible Gambling certification. The World Lottery Association is an international association of state-controlled lotteries that provides a forum for lotteries to promote their collective interests. A Level 4 certification means that the World Lottery Association has determined that the Lottery has a “documented and progressive commitment to responsible gaming.” The Lottery directed Cactus to procure the study and paid \$57,400 for the study through disbursements to Cactus.

What audit work was performed and what was the purpose?

We reviewed statutes, rules, and the OSC’s policies related to state procurements. We also reviewed Lottery documentation related to the Fiscal Year 2022 advertising services solicitation and selection process, including planning documents such as the evaluation plan that identified the committee members and detailed the selection process, scoring materials, and protest records. We also reviewed the request for bids that Cactus issued for the gambling prevalence study, the scoring of the bids submitted for the study, the study results, and the Lottery’s application to the World Lottery Association.

We interviewed Lottery staff to understand their procurement and decision-making processes; staff from the Department’s Purchasing and Contracts Section who were involved in the advertising contract procurement, and the OSC’s staff to understand procurement requirements; and firms that responded to the RFP, but were not awarded the advertising contract, for their perspectives on the procurement process.

The purpose of the audit work was to determine if the Lottery’s solicitation and selection procedures for the Fiscal Year 2023 advertising services contract and its procurement of the gambling prevalence study were effective in achieving the underlying purposes of the Procurement Code (described in the following section) and adhered to statutory requirements, procurement rules, and OSC policies.

How were the results of the audit work measured?

Overall, the purpose of the State Procurement Code [Section 24-101-102, C.R.S.] is to increase public confidence in public procurement; ensure the fair and equitable treatment of those

contracting with the State; maximize, to the extent possible, the value of public funds; foster competition; and establish safeguards for quality and integrity in the procurement process. We identified the following criteria in statute and rule that establish controls to ensure that State procurement processes, such as the Lottery's, are fair and transparent.

Documentation to Support Decision-Making. State statute [Section 24-103-203 (7), C.R.S.] regarding procurement through an RFP, says, "The award shall be made to the responsible offeror whose proposal is determined *in writing* to be the most advantageous to the state, taking into consideration the price and the evaluation factors set forth in the request for proposals *The contract file shall contain the basis on which the award is made.*" [emphasis added] Additionally, state procurement rules [1 CCR 101-9, R-24-101-201-02] require each written determination to "set out sufficient facts, circumstances, and reasoning to substantiate the specific determination which is made," and statute [Section 24-101-402, C.R.S.] requires that all procurement records be retained and disposed of in accordance with records retention guidelines and schedules. The State Controller's policy on Records Retention for Contracts requires agencies to "retain all official contract files for at least six years after the contract expires or terminates." The Department's Purchasing and Contracting Section has guidelines that further define what records are required to be collected and recorded, including deliberative materials and notes taken by RFP committee members.

Selection Committee Composition. Lottery's statute requires a person who is neither employed by nor affiliated with the Lottery to serve on the selection committee for any solicitation over \$1 million [Section 44-40-106(12), C.R.S.].

Procurement Authority and Responsibility. Procurement of services needed by a state agency is governed by procurement rules. During the audit period, these rules [1 CCR 101-9, R-24-103-201-01] stated that procurement of services greater than \$25,000 must be reviewed by the agency's procurement official and that the solicitation is to be conducted only by a procurement official or their designee. The rules also grant agency procurement officials specific authority, such as determining what type of solicitation should be used (e.g., request for proposal, documented quote, invitation to bid); establishing the process to evaluate responses; and approving the award of a contract to the selected firm. Further, procurement rules require that the criteria used to evaluate proposals be set forth in the request for proposals [1 CCR 101-9, R-24-103-203-02].

In some cases, a state agency may obtain services by having an existing primary contractor execute a subcontract for the work, as long as that work is within the overall scope of the primary contract. For example, the Lottery's advertising contract allows Cactus to subcontract with third parties to "aid in performance" of the work stipulated in the contract. When we talked with procurement experts in the OSC, and with the Department's Purchasing and Contracting Section, they confirmed that, therefore, Cactus should only subcontract for services relating directly to advertising or marketing and that, more generally, subcontracting should not be used as an alternative to state procurement.

What problems did the audit work identify?

We found that the Lottery’s selection procedures for its Fiscal Year 2023 advertising services contract and its procurement of the gambling prevalence study may not have been as effective as they could have been in achieving the underlying purposes of the Procurement Code, and may not have complied with some state procurement requirements, as described below.

Documentation to Support Advertising Contract Selection. We found that the Department’s procurement file for the contract did not contain documentation to show how the Lottery determined that the proposal submitted by Cactus was the most advantageous to the State, taking into consideration the price and the evaluation factors set forth in the RFP, or the basis on which the award was made, as required by statute. The procurement file included the scoring sheets reflecting the evaluation committee’s assessment of the four written proposals submitted and the award letter. However, the approved recommendation for award only stated that the award was advantageous to the State, listed the requirements for award from the RFP, and stated that Cactus met those requirements. In addition, the file did not include any documentation, other than the Phase 1 scoring sheets, to indicate how the committee made its determination—that is to say, how the site visits in Phase 2 informed the committee’s final award recommendation. During Phase 1 of the selection process, Cactus and one other offeror scored the same on their technical proposal, and the other offeror had proposed a lower cost. However, the procurement file did not contain any documentation to show what information was provided during the presentations to justify selecting Cactus over the other offeror, who proposed a lower cost. An offeror protested the Lottery’s decision to select Cactus for the contract; the Department’s Procurement Official’s response to the protest was that the “final award decision...was ultimately a business judgment that reflected an integrated assessment of the relative merits of proposals using the factors listed in the RFP. Award to Cactus was determined to be most advantageous to the State based on evaluation factors disclosed in the RFP.” The protesting offeror did not appeal the protest response.

It is possible and reasonable that the Lottery found value in continuing to contract with Cactus—familiar with the Lottery’s processes, the state of the Lottery in Colorado, and the advertising environment in Colorado—and that it benefits from a seamless continuation of services. However, there is no documented discussion of the extent to which this or any other reasoning, such as the information provided by the offerors during the site visits, that may have contributed to the Lottery’s decision that contracting with Cactus would be the most advantageous to the State.

Appointment of an Unaffiliated Individual. We found that the evaluation committee did not include an unaffiliated individual, as required by statute [Section 44-40-106(12), C.R.S.]. There were a total of five people on the committee—four Lottery employees and one person appointed to serve as the unaffiliated committee member, who was the account manager with the contractor the Lottery uses for its scratch game production. In June 2022, the Lottery had entered into an

enhanced partnership with this contractor to expand the services that they provide to the Lottery, with the contractor's compensation based on increased sales. Although statute does not define "affiliated" or explain the legislative intent behind this requirement, it would seem that the purpose of this provision was to ensure that at least one member of the Lottery's evaluation committees for high-dollar contracts be independent from the Lottery and be able to objectively evaluate offerors. This requirement was put into statute in the 2004 Legislative Session when the General Assembly also changed the Commission from a type-1 to a type-2 board and required them to develop a code of ethics. This indicates that, at that time, the General Assembly may have had concerns with the Lottery Commission operating in an ethical manner and, therefore, wanted an independent voice in its contracting processes. An individual employed by one of the Lottery's contractors and one who also has a professional working relationship with Lottery staff and a vested interest in increasing lottery sales would seem to be "affiliated" with the Lottery, inconsistent with legislative intent.

Procurement Authority and Responsibility. By directing Cactus to subcontract for the gambling prevalence study, the Lottery avoided the Department's procurement controls, including having the Department's procurement official determine the proper form of solicitation, conduct the solicitation, determine how responses should be evaluated, and approve the selected contractor. The procurement of the study also did not clearly fall within the scope of the advertising services contract, which does not assign Cactus any responsibility for research on gambling prevalence or responsible gambling. Further, the request for bid for the study did not indicate that the results would be used for marketing or advertising; it indicated the study was needed to help the Lottery promote responsible gaming and stated that the main objective of the study was "to determine current baseline measures of the prevalence of gambling and problem gambling ..." in comparison to 1997 data—the last time such a study was conducted. The request for bids listed 15 objectives that do not appear to support advertising efforts, including:

- Categorize participants into three problem gambling risk factors and four gambling frequency groups. Use an established screening tool to measure the proportion of problem gamblers within a population.
- Identify types of gambling Coloradoans participate in, the types that cause them the greatest difficulties, and why they gamble.
- Determine public perception of gambling and if Colorado residents think the Lottery promotes addiction to gambling.
- Determine if individuals can recognize the signs of problem gambling and would seek help.
- Understand the mental health conditions that may be related to problem gambling.
- Measure awareness of Lottery responsible gambling marketing; whether Coloradans benefit from it; and awareness of public treatment services and supports for problem gambling.

Why did these problems occur?

The Department and the Lottery do not have sufficient policies and procedures related to the procurement process to ensure that contracting decisions adhere to applicable requirements.

- **Lack of Guidance on Documenting Decision-Making.** The Department does not have policies or procedures to provide guidance to Lottery staff on how to sufficiently document contracting decisions. The RFP evaluation plan describes how to score the written proposals, with the numerical scoring being used to identify offerors deemed reasonably susceptible of being selected for award to participate in a site visit by committee members. However, the plan does not direct evaluation committee members on how to document their evaluation of the site visits. The plan states that “[t]his portion of the evaluation will not involve scoring but will be considered in the final recommendation.” Notes were not collected as required and no documentation describing the site visits was contained in the contract file. Although the plan states that the final award decision is a “business judgment that will reflect an integrated assessment of the relative merits of the proposals using the factors and their relative weights,” it does not explain how evaluation committee members should use the factors and weights to assess the site visits, since the site visits are not numerically scored. Further, the plan does not provide guidance on how the committee members should consider information from the site visits relative to the written proposal scores when deciding on which offeror to recommend for a contract.
- **Lack of Guidance on Committee Composition.** The Lottery does not have policies or procedures that define “affiliated” as it relates to the Lottery’s contracting and selection process. Statute [Section 44-40-106(12), C.R.S.] states, “[t]he evaluation team for any bid for a contract for services . . . shall include an individual who is neither employed by nor affiliated with the [Lottery].” However, there is no definition of what it means to be affiliated with the Lottery. According to the Lottery, it is difficult to find individuals with the expertise and knowledge of Lottery operations who have no connection to the Lottery, and the person they chose to serve on the selection committee in this capacity had that expertise. The Lottery Director sent an email to the Department’s Procurement and Contracting Section naming the individual who had been selected to serve as the member of the selection committee who was not affiliated with the division and detailing their experience and knowledge of lottery games, but they did not explicitly disclose the direct business relationship that this individual had with the Colorado Lottery. This information could have been helpful for Department procurement staff. Department procurement staff stated that they do not select or approve the outside individual, but that they were primarily concerned with conflicts of interest for committee members and that they did not determine that there was a conflict of interest with this individual.

- **Lack of Guidance on Subcontracting.** The Lottery told us that, when it is initiating a procurement, it generally asks the Department’s Purchasing and Contracts Section if the services needed are within the scope of an existing contract and can, therefore, be obtained through a subcontract. The Lottery wanted the gambling prevalence study completed with a short turnaround, and Cactus was able to complete the procurement process—from advertising the project to executing a subcontract—in about a month, where it would have taken the Lottery longer to procure it under state procurement rules. For instance, during our audit period, the Lottery contracted for its advertising service in a process that took 4 months from posting the RFP to award. Lottery staff also told us that they believed the study fell within the bounds of the contract with Cactus, which does state that one of the contractual obligations is to “coordinate purchase and payment of goods and/ or services associated with [advertising and client services]” which might include “... professional services *as determined by Lottery.*” [emphasis added]. However, the Lottery did not seek Department guidance on whether this language, or any other part of the contract, allowed for the subcontract of the gambling prevalence study.

While they do have contract monitoring manuals and training, neither the Lottery nor the Department’s Purchasing and Contracts Section have written policies that instruct Lottery staff on how to determine whether a purchase to be made under an existing contract will fall within that contract scope of work. Such policies could include guidance to review the contract scope and compare with the planned purchase, consult with the Department, and document the conclusion.

Why do these problems matter?

When the Lottery cannot demonstrate that it is effectively achieving the purposes of the State Procurement Code and that it has fully complied with all requirements when procuring contractor services, it can potentially undermine the confidence the public and entities involved in the lottery industry have in the Lottery’s procurement processes, and call into question whether these contracts maximized the value of the funds used to pay for them.

Risking Public Trust. With respect to the advertising services contract, continually contracting with the same vendor for 16 years, without having complete documentation of the selection for the most recent procurement, can foster the perception that the Lottery’s advertising services contract is not available to competitive proposals. This could undermine the credibility of the Lottery’s solicitation process. Offerors that experience what they perceive to be unfair treatment are unlikely to participate in future State procurements, which reduces the overall competitiveness of services available to the State. Incumbent vendors should not be penalized for already having a business relationship with an agency. However, without clear documentation of the selection committee’s decision-making process, the Lottery may not be able to adequately justify its decision to continue with the same vendor for up to another 8 years, or a total of 23 years.

With respect to the gambling prevalence study, by using Cactus to subcontract for the study, the procurement was less accountable and transparent than if the Lottery had solicited the study itself. For example, although the study was solicited and contracted for by Cactus, the request for bid indicated that the Lottery was the customer. The request for bid was titled “Colorado Lottery 2020 Problem Gambling Prevalence Study,” and included statements such as “The Lottery would like the study design to be as close to the 1997 study as possible ...” and “The Lottery would like a recommendation from the vendor on which screening tool is best to use for this study and why.” The request also stated that “Consulting with Lottery staff ... for questionnaire development is also required.” Further, two Lottery staff were involved in scoring the bids submitted to Cactus, although typically a subcontract is handled entirely by the primary contractor.

Maximizing the Use of Public Funds.

In addition, one drawback of the Lottery obtaining the gambling prevalence study through a subcontract under Cactus is that the Lottery gave up its ability to oversee the services and ensure the resulting product met expectations. The Lottery paid \$57,400 to the subcontractor through Cactus for the gambling prevalence study, but it is unclear how the Lottery used the results other than to apply for its Responsible Gaming Certification. Although the study indicated that some Lottery products were key factors in gambling addiction, there is no indication that the Lottery used this information to modify its advertising, expand or improve its responsible gambling messages, or inform its decisions on products.

Finally, by asking Cactus to subcontract for the study that was not directly related to the advertising or marketing services under the existing contract, the Lottery may have incurred a statutory violation for the full amount of the subcontract. According to OSC policies, a statutory violation occurs when a state agency incurs an obligation or makes a payment on the State’s behalf without the prior approval of a purchase order or a contract. Incurring an obligation for goods or services that exceed the scope of work of an existing contract is an example of a violations. Thus, the Lottery placed its employees at risk of being personally liable for the cost of the study because it appears to have not been under the scope of work in the advertising services contract.

Recommendation 6

The Colorado Lottery (Lottery) should work with the Department of Revenue (Department) to help ensure that its contracting processes are consistent with the purposes of the State Procurement Code and that its contracting process aligns with state procurement requirements by developing and implementing written policies and procedures that:

- A. Provide guidance on how to sufficiently document contracting decisions. This should include guidance on how to factor in the results of site visits relative to written proposal scores when deciding on which bidder to recommend for a contract.

- B. Define what constitutes an “affiliation” with the Lottery and require staff to follow this definition when recommending selection committee members.
- C. Revise its training and guidance documents for contract monitors to include information on how to determine whether a service can be properly procured through an existing contract or must be acquired through a state procurement. This could include a requirement that Lottery staff work with the Department’s Procurement and Contracting Section when making this determination and document the decision.

Response

Colorado Lottery

- A. Agree

Implementation Date: June 2024

The Colorado Lottery will work with the Department to improve its guidance by creating a template recommendation for award to ensure that the procurement file for any future RFP process demonstrates its full compliance with Procurement Code and Rule and provides transparency in its award determination.

- B. Agree

Implementation Date: June 2024

The Colorado Lottery will work with the Department to define affiliation with the Lottery in a policy and require staff to follow this policy when recommending selection committee members.

- C. Agree

Implementation Date: June 2024

The Colorado Lottery will work with the Department to revise its contract management policy and contract manager training to include information on how to determine whether a good or service is within scope of a contract, when to contact the Purchasing and Contracts Section, and how to document scope decisions in the contract file.

Appendix

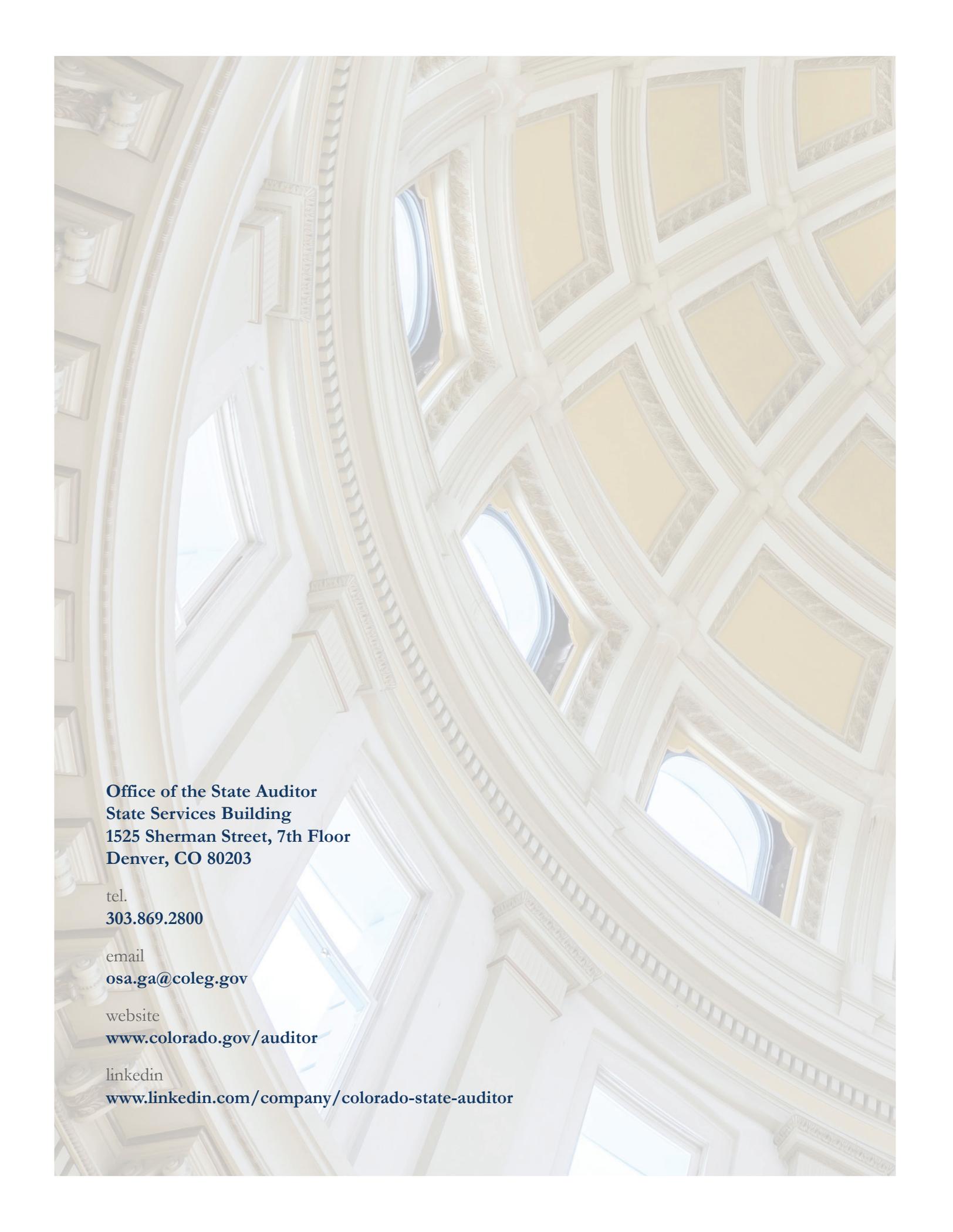


Statutory Considerations

Statute [Section 44-40-120, C.R.S.] requires the State Auditor to analyze the performance of the Lottery at least once every 5 years. That analysis shall consider a number of factors. We list those factors below, as well as their disposition based on the audit work conducted.

Statutory Factors Section 44-40-120, C.R.S.	Disposition
(c)(I) The amount of revenue generated by the lottery for its beneficiaries as specified in article XXVII of the state constitution;	We provide this information in Chapter 1.
(c)(II) The administrative and other expense of lottery dollar collections as compared to revenue derived;	We provide this information in Chapter 1.
(c)(III) An evaluation of the contracts, and compliance with the contracts, of lottery equipment contractors and licensed sales agents;	We conducted work on 3 of the Lottery’s largest contracts. The procurement for one contract and for a subcontract are discussed in Chapter 2.
(c)(IV) Whether there has been an increase in organized crime related to gambling within the state;	Based on a risk assessment in the planning phase of the audit, nothing indicated a lack of compliance with state laws or lack of internal controls in this area.
(c)(V) A report on the results of the analysis prepared by the division on the socioeconomic profile of persons who play the lottery, including information comparing the results of past analyses to assess the movement of persons from various categories;	We reviewed the Lottery’s quarterly tracking studies and the demographic categories identified by segmentation studies. Our evaluation of the procurement for a gambling prevalence study is included in Chapter 2.
(c)(VI) Whether the commission encourages public participation in its decisions rather than participation only by the people whom it regulates;	We discuss our finding in this area in Chapter 2.
(c)(VII) An evaluation of the effectiveness and efficiency of the division’s complaint, investigation, and disciplinary procedures;	We discuss our findings in this area in Chapter 2.
(c)(VIII) Whether the division performs its statutory duties efficiently and effectively;	We discuss our findings in this area in Chapter 2.
(c)(IX) Whether administrative or statutory changes are necessary to improve the operation of the lottery in the best interests of the state’s citizens;	We discuss our findings in this area in Chapter 2.
(c)(X) Any other matters of concern about the operation and functioning of the lottery; and	We discuss our findings in this area in Chapter 2.
(c)(XI) A report on any gifts and gratuities received by members of the commission and employees of the division.	On the basis of the work we performed in this area, nothing came to our attention to indicate a lack of compliance with state law or lack of internal controls.





**Office of the State Auditor
State Services Building
1525 Sherman Street, 7th Floor
Denver, CO 80203**

tel.
303.869.2800

email
osa.ga@coleg.gov

website
www.colorado.gov/auditor

linkedin
www.linkedin.com/company/colorado-state-auditor